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In the Supreme Court of the United States

OCTOBER TERM, 1996

FIRST JERSEY SECURITIES, INC. AND
ROBERT E. BRENNAN,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Both Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b), and Section 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(e), confer jurisdiction on federal district courts, on application by the SEC, to grant a "permanent or temporary injunction or restraining order" forbidding acts or practices that violate these statutes. But neither statute confers jurisdiction to order disgorgement of profits received from allegedly illegal acts or practices.

In this case a federal district court ordered petitioners to disgorge $75,000,000. That amount, which includes $53,000,000 in prejudgment interest, is the largest non-consensual disgorgement judgment in the history of the federal securities laws. Both petitioners have been forced into bankruptcy.

The questions presented are:

1. Whether, in the absence of any statutory authorization, federal courts have "broad equitable power" to fashion a disgorgement remedy to effectuate the "deterrence objectives" of the federal securities laws.

2. Whether, in the absence of any statutory disgorgement standards, federal courts may disregard equitable limitations in framing disgorgement orders, thereby requiring a defendant to disgorge money he never received to an entity to whom he owes no debt, and effectively nullifying constitutional and procedural safeguards that apply whenever the government seeks to impose a penalty.

PARENT COMPANIES AND SUBSIDIARIES

First Jersey Securities, Inc., a corporation now in bankruptcy, has no parent companies or subsidiaries that have issued shares to the public.

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v.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

First Jersey Securities, Inc. and Robert E. Brennan respectfully petition this Court for a writ of certiorari to review the judgment entered by the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-47a)[1/] is reported at 101 F.3d 1450. The opinion of the district court (App. 48a-104a) is reported at 890 F. Supp. 1185.

[1/] "App." refers to the separately bound appendix to this petition.

JURISDICTION

The court of appeals issued its opinion on December 10, 1996. Petitioners filed a timely petition for rehearing with suggestion for rehearing *en banc*, which was denied on February 27, 1997. App. 219a. This petition is being filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

1. Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b), provides in pertinent part:

> Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States or United States court of any Territory, to enjoin such acts or practices and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter.

2. In substantially identical terms, Section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d), provides as follows:

> Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning

such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

STATEMENT OF THE CASE

1. Introduction. This petition arises from a decision by the court of appeals affirming the largest adjudicated disgorgement award in the history of the federal securities laws. The $75 million judgment at issue, including $53 million in prejudgment interest, was the culmination of a civil action filed more than 10 years earlier by the Securities and Exchange Commission ("SEC"). As a result of the disgorgement judgment, which exceeds the amount of money petitioner Brennan actually received by more than $74 million, both petitioners were forced into bankruptcy.

The two questions presented in this petition are frequently recurring and exceptionally important to the administration of the federal securities laws. The first question is whether there is any statutory basis for disgorgement. That remedy has evolved into the form of ancillary relief most commonly granted to the SEC by federal district courts, even though the statute invoked by the SEC as authority for imposing it does not mention disgorgement at all. In fact, the SEC noted in its 1995 Annual Report (at 1) that, in that year alone, it had "obtained court orders requiring defendants to disgorge illicit profits of over $994 million." Given the mistaken but long-entrenched view of disgorgement held by the lower federal courts, there is great practical need for this Court's review.

The second question presented follows directly from the first. If courts are given the power to imply a disgorgement remedy, every aspect of disgorgement, including the rules defining the amount to be disgorged, must be created by judges on an ad hoc basis. In this case, the Second Circuit fashioned an ad hoc remedy requiring petitioner Brennan to disgorge more than 75 times the profits he received in order to maximize "deterrence." That decision turns the law of disgorgement on its head, greatly expanding the judicially-conferred powers of the SEC and, in the process, creating a split with every other court that has addressed the question. If lower courts can create an implied disgorgement remedy,

then this Court should define the boundaries of the lower courts' discretion to mete out disgorgement awards.

2. **The decision of the district court.** Petitioner First Jersey Securities, Inc. ("First Jersey") was founded in 1974 as a full-service broker-dealer, specializing in the securities of emerging growth companies. App. 105a. Petitioner Robert Brennan served as president or chief executive officer of First Jersey during the period in question. *Id.* at 128a. The disgorgement judgment entered below was based on a determination by the district court that petitioners had violated the anti-fraud provisions of the federal securities laws by charging excessive prices in the retail sales of securities in the over-the-counter market. *Id.* at 48a-104a. On the basis of its finding of excessive markups, the district court ordered petitioners jointly and severally to disgorge the sum of $22,288,099 (the profits earned by First Jersey on the securities at issue), plus $52,689,894 in prejudgment interest. *Id.* at 223a. The district court also enjoined petitioners from violating the securities laws. *Id.* at 222a.

The trial record established that First Jersey was not a one-person operation, but a large business serving customers in many states. According to the district court's findings of fact, from November 1, 1982 through January 31, 1987, First Jersey's organization had six major departments, including Sales and Trading. *Id.* at 105a. From 1984 through January 1987, First Jersey operated approximately 32 retail branch offices and, at its height, approximately 36 retail offices throughout the United States. *Id.* at 106a. As of October 1986, First Jersey had a retail customer base of more than 500,000 accounts. *Id.* at 107a. First Jersey employed approximately 1,200 registered representatives. *Id.* The sheer size of the operation required Brennan to delegate many responsibilities, such as pricing. Tr. 1541-42, 2739, 2823.

According to the undisputed record, although petitioner Brennan personally received a total of $14 million in compensation from First Jersey over the four-year period in question (App. 130a), *less than $1 million* of that amount was attributable to the allegedly improper transactions (*id.* at

228a). The district court nevertheless required him personally to disgorge the full $22 million amount of First Jersey's gross profits from those transactions, plus interest. The district court did so on the ground that Brennan was the owner of First Jersey and was jointly and severally liable for the violations at issue. *Id.* at 99a-101a. The court made no finding that First Jersey lacked a separate existence from Brennan so as to justify piercing the corporate veil, and the SEC sought no such finding.

The district court did not fashion this sweeping relief to compensate the victims of the alleged fraud. Beginning in October 1985 and coinciding with the filing of the SEC's complaint in this case, several class actions were filed on behalf of all of First Jersey's customers with regard to the same securities transactions at issue here. In 1987, after extensive discovery was taken and a consolidated class action complaint was filed, mirroring the SEC's complaint in this case, all plaintiffs agreed to a judicially-approved settlement and released their claims. *Id.* at 230a-247a. Indeed, the SEC repeatedly acknowledged during the proceedings below (*e.g.*, Tr. 555, 1059, 1143-45) that any funds obtained through disgorgement will be paid to the U.S. Treasury and *not* to any victims of the alleged fraud.[2/]

The district court more than tripled the size of the award against Brennan and First Jersey by calculating prejudgment interest at the IRS underpayment rate. App. 101a. Denying petitioners' request that it make specific factual findings with respect to the appropriate rate of interest applicable to any disgorgement award, the court instead opted, without discussion, analysis or factual findings, to calculate interest automatically at the rate proposed by the SEC in every case.[3/] In doing so, the district court also denied petitioners the

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[2/] In its brief submitted to the Court of Appeals (at 47-48), the SEC expressed doubt about what to do with the money, stating that "it is not yet clear where the disgorged proceeds will go."

[3/] The SEC takes the position that courts should apply the IRS underpayment rate, which equals the federal short-term rate plus three percentage points, in all cases regardless of their facts. 17 C.F.R. § 201.600(b).

opportunity to present evidence that the interest should be reduced to reflect delay chargeable to the SEC's own conduct in taking over ten years to pursue the case. *Id.* at 102a.

3. The decision of the court of appeals. The Second Circuit affirmed the disgorgement award on the ground that disgorgement fulfills the "deterrent purpose" of the federal securities laws. *Id.* at 38a. The court nowhere addressed petitioners' arguments concerning the absence of any express disgorgement remedy in the text of the governing statutory provisions. Instead, the court reasoned that "[o]nce the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remedies, . . . thereby effectuating the deterrence objectives of those laws." Throughout its opinion, the court stressed that disgorgement, "unlike an award of damages," serves to punish the defendant financially and thereby deter future violations: "the primary purpose of disgorgement as a remedy for federal securities laws violation is deterrence." *Id.* at 38a, 39a.

The Second Circuit relied on its seminal disgorgement decision, *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971), for the proposition that disgorgement is necessitated by the generalized "purposes" embodied in the federal securities laws, rather than the statutory text. *Id.* at 38a. The additional Second Circuit decisions cited by the panel (*id.*) uncritically followed the ruling in *Texas Gulf Sulphur*, without attempting to reconcile the disgorgement remedy with the governing language of the federal securities laws, the legislative history, or this Court's recent decisions limiting the creation of implied remedies.

The Second Circuit also made clear that the disgorgement remedy is subject to few, if any, limitations enforceable by appellate courts. As to every objection raised to the disgorgement order, the court simply recited that the district court had "discretion" to resolve such issues. *E.g., id.* at 38a. Initially, the Second Circuit ruled that the district court's disgorgement award — even to the extent that it "ordered [petitioner Brennan] to disgorge more than the profits he personally received from the transactions in

question" — fell "within the court's discretion." *Id.* at 40a. The court further concluded that because Brennan, as the owner of First Jersey, "could" (but did not) "request a check in any amount at any time and the Firm would issue one to him," it was once again within the district court's "discretion" to extend disgorgement to any personal enrichment that Brennan *might* have obtained. *Id.* With regard to the award of $53 million in prejudgment interest, the Court once more invoked the district court's "broad discretion," and once again reasoned that "[i]n an enforcement action brought by a regulatory agency, the remedial purpose of the statute takes on special importance." *Id.* at 41a. Finally, given the Second Circuit's characterization of disgorgement as "remedial" or "equitable" rather than "punitive" (*id.* at 38a), the court rejected without discussion petitioners' contention that the SEC's claim was barred under the statute of limitations that applies to government penalty proceedings, and that the $75,000,000 "deterrent" order in this case was meted out without a trial by jury in violation of the Seventh Amendment.

Although the Second Circuit's decision addressed several controversial issues on the merits, this petition is concerned only with disgorgement.

REASONS FOR GRANTING THE PETITION

The decision of the Second Circuit raises important issues of statutory interpretation that are critical to the proper administration of the federal securities laws. The Second Circuit's creation, by judicial implication, of a disgorgement remedy never granted by Congress cannot be reconciled with recent decisions of this Court, and its rejection of traditional limitations applicable to equitable relief in federal court is at odds with the law in other circuits. The Second Circuit's treatment of those issues plainly warrants further review.

I. THE SEC'S DISGORGEMENT ORDER CLASHES WITH THIS COURT'S RULINGS LIMITING IMPLIED REMEDIES

There is no inter-circuit conflict on the first issue presented. That is traceable to the fact that the Second Circuit has long been the dominant "mother circuit" in the

field of federal securities litigation given its geographical link to the New York financial markets. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting). This dominant position often leads the Second Circuit, as happened in this case, to rely solely on its own precedents in resolving important federal securities law issues. Other circuits have uncritically followed the lead of the Second Circuit, declining to retrace its original steps in *Texas Gulf Sulphur* or to determine whether disgorgement comports with this Court's more recent precedents. Given the entrenched misconception of the law in the lower federal courts on the issue of disgorgement, the absence of a conflict in no way detracts from the certworthiness of this case. The Second Circuit's decision qualifies for review because, in the words of Rule 10(c), the decision raises critical issues of federal statutory interpretation that "have not been, but should be, settled by this Court," and the Second Circuit has so far departed from the accepted course of statutory interpretation of the federal securities laws "as to call for an exercise of this Court's supervisory power." Sup. Ct. R. 10(a).

This Court has not hesitated to grant certiorari and reverse lower court decisions when expansive constructions of the securities laws, such as the one in this case, conflict with the literal language that Congress has used or with rules of statutory interpretation laid down by this Court. *See, e.g., Central Bank of Denver* v. *First Interstate Bank of Denver*, 511 U.S. 164, 192 (1994). The existence of an inter-circuit split is by no means a prerequisite for certiorari to be granted when important questions are raised concerning the securities laws. *See, e.g., Dirks* v. *SEC*, 463 U.S. 646 (1983); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979); *SEC* v. *Sloan*, 436 U.S. 103 (1978); *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462 (1977); *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975); *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49 (1975); *see generally*, 1 Bromberg & Lowenfels, SECURITIES FRAUD AND COMMODITIES FRAUD 2:108 (1996) ("There can be little doubt about the intensity of the Court's concern over the

expansion of securities liability, and its determination to curb.").

The first question presented is a frequently recurring one of exceptional practical importance. The judge-made disgorgement remedy fundamentally enhances the bargaining position of the SEC. In hundreds if not thousands of settled cases, the agency can use the threat of massive disgorgement to intimidate securities professionals, corporations and other securities law defendants into accepting onerous settlement terms. Given the near-complete deference the SEC receives from lower courts, as demonstrated by this case, the Commission now exercises uncodified, but immense and effectively unreviewable powers in a critical sector of the private economy.

The disgorgement remedy claimed in this case is so far removed from the language of the 1933 and 1934 Acts that it did not occur to the SEC to seek it for more than 30 years.[4/] In *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir. 1971), the SEC was granted disgorgement powers for the first time in a contested enforcement proceeding. Since then, despite the absence of any statutory authority and despite the absence of any support from legislative history, disgorgement has, according to a former general counsel of the SEC, grown into "the principal

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[4/] In the words of a leading scholarly study (Ellsworth, *Disgorgement in Securities Fraud Actions Brought By The SEC*, 1977 Duke L.J. 641, 642): "Nowhere within the statutory framework of the federal securities laws did Congress provide that the SEC would have the power to make a violator of the anti-fraud provisions disgorge tainted profits. Nor is there any direct reference in the legislative history surrounding the passage of the 1933 or the 1934 Acts which would encourage the utilization of such an enforcement tool by the SEC. It would appear that the dearth of legislative support dissuaded the Commission for some three decades from testing in court the right to obtain such relief." Nevertheless, "[o]ver the last fifteen years the SEC has obtained, with increasing frequency and on a scale unprecedented in administrative law, a broad range of equitable remedies, generally known as 'ancillary remedies' or 'ancillary relief' — not expressly authorized by federal statutes." Dent, *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 Minn. L. Rev. 865, 865 (1983).

equitable remedy sought by the Commission."[5/] As demonstrated below, the disgorgement remedy was fashioned by the courts in an era of expansive interpretation of the securities laws, which assumed the propriety and desirability of an active law-making role by the federal judiciary in carrying out broad remedial statutory goals, regardless of what the statute expressly stated. That approach, however, has now been firmly rejected by this Court. The precisely-calibrated remedial scheme that Congress put in place to deter and punish securities law violators simply does not provide for the kind of ad hoc disgorgement remedy fashioned here.[6/] Given the current, widespread use of disgorgement in SEC enforcement actions, this case warrants further review.

A. This Court's Recent Decisions Forbid The Creation of Implied Remedies That Distort The Scheme of Remedies Expressly Fashioned by Congress.

1. Judicial revision of explicit remedies. No one disputes that the federal securities laws do not expressly allow courts to grant disgorgement. Courts awarding disgorgement, therefore, have been forced to rely on two provisions enabling the Commission to seek only *injunctive* relief. Section 20(b) of the 1933 Act, 15 U.S.C. § 77t(b), and Section 21(d) of the 1934 Act, 15 U.S.C. § 78u(d), empower the SEC to bring a civil action "to enjoin" specific "acts or practices" that constitute a violation of the statute. The relief available to the SEC is specifically described: "Upon a proper showing, a permanent injunction or temporary injunction or restraining order shall be issued." If deterrence of future misconduct is called for, the SEC may "transmit such evidence as is available" to the Attorney General, who "may institute the necessary criminal

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[5/] Ferrara, *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 Bus. Law. 33, 73 (1991).

[6/] "The results of the case-by-case approach, which now prevails, are that the district courts are assuming the essentially legislative function of defining remedies for statutory violations, often disregarding the purposes of the securities laws." Dent, *Ancillary Relief, supra*, 67 Minn. L. Rev. at 927.

proceedings." *Id.* This is not a case where the statute empowers a court to enter an "injunction, or *other order*." *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 399 (1946) (emphasis supplied). The provisions at issue here, by their clear terms, authorize injunctive relief only and make no mention of any catchall language which might authorize disgorgement.

Despite the "forward looking" and limited nature of the injunctive remedy expressly prescribed in the securities laws, courts have implied from that narrow remedy the ability to "reach back" in time and order disgorgement of profits, even from long ago. In the seminal disgorgement case, *Texas Gulf Sulphur Co.*, 446 F.2d at 1307-08, the Second Circuit grafted onto the SEC's express power to seek limited injunctive relief an implied power to obtain unlimited disgorgement. The court recognized that nothing in the text of the statute authorized disgorgement, and that the "legislative history" may be "contrary" to such a remedy, but nonetheless based the disgorgement remedy on "general equity powers under Sec. 27 of the Act." *Id.* at 1307. The focus of the court's inquiry was not on the words of the statute, but rather on the court's own judgment as to whether disgorgement would "effectuate the purposes of the [securities laws]." *Id.* at 1308. Decisions following *Texas Gulf Sulphur* have offered no substantive explanation of how the disgorgement power can be implied from the securities laws other than reliance on broad remedial purposes. The analysis in *Texas Gulf Sulphur* conflicts with this Court's jurisprudence (*see infra* pp. 13-20), and those errors have simply replicated themselves over the years without any critical reconsideration.[7/]

Although originally considered to be "ancillary" to the injunctive remedy expressly provided by statute, disgorgement has grown into the primary remedy employed by the SEC. As recently as 1986, for instance, only ten reported federal court decisions addressed the issue of

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[7/] *E.g.*, *SEC* v. *Materia*, 745 F.2d 197, 200 (2d Cir. 1984) ("any form of ancillary relief may be granted where necessary and proper to effectuate the purposes of the statutory scheme").

disgorgement in the context of SEC enforcement actions. In 1996, by contrast, there were over 40 such decisions.[8/] Disgorgement has become a nearly $1 billion per year implied remedy for the SEC. The $75 million disgorgement award below — reaching back over ten years — is the latest and most striking example of how a so-called "ancillary" implied remedy has grown to dominate the enforcement scheme.[9/]

The consequences of that development have been dramatic. To begin with, SEC injunctions are by no means a "mild prophylactic" but rather, represent "drastic remedies." *Aaron* v. *SEC*, 446 U.S. 680, 703 (1980) (Burger, C.J., concurring). Given the additional implied remedy of disgorgement, the SEC's leverage over securities professionals and market participants increases enormously, especially considering the near-complete deference which the SEC receives from lower courts with regard to awarding disgorgement, as shown by this case. The end result is that the SEC has vast and effectively unreviewable powers that are nowhere codified in any statute. This Court has warned against such a result: "Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy . . . [which] can be hazardous . . . ." *Dirks* v. *SEC*, 463 U.S. 646, 664 n.24 (1983); *see also SEC* v. *Sloan*, 436 U.S. 103, 123 (1978) (Brennan, J., concurring) (describing expansive SEC sanctions as "flagrantly abusive . . . . no reasonable person could suppose that Congress intended to authorize such a thing"). As former SEC Commissioner Roberta Karmel has explained, "[t]he potential for abuse is great when a government prosecutor is not held to the limitations and standards of a

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[8/] This survey was limited to cases reported on Westlaw, and accordingly does not take into account a large number of other disgorgement cases, including those in which the defendants consented to the relief sought.

[9/] *See, e.g.*, Stern, Gressman, Shapiro & Geller, SUPREME COURT PRACTICE 188 (7th ed. 1993) (the fact that "especially large amounts of money are involved in litigation over the issue of statutory construction may also be a persuasive factor" in granting certiorari, especially where "the amount is enormous").

specified statutory remedy." Karmel, REGULATION BY PROSECUTION 201 (1981). [10/]

2. The requirements of separation of powers. Judicial implication of a remedy like disgorgement, so frequently employed and so far-reaching in impact, raises profound questions concerning the separation of powers. Indeed, *Texas Gulf Sulphur* and its progeny are directly at odds with this Court's jurisprudence, which demands "respect" for "the compromise embodied in the words chosen by Congress," *Mohasco Corp.* v. *Silver*, 447 U.S. 807, 826 (1980), and recognizes that Congress, rather than the judiciary, should control the availability of controversial remedies for violations of federal statutes. *See Northwest Airlines, Inc.* v. *Transport Workers Union of America*, 451 U.S. 77, 95 (1981); Easterbrook, *Statutes' Domain*, 50 U. Chi. L. Rev. 533, 540-42 (1983) (since the 1934 Act "already comes right up to the line in offering protection for investors," additional implied remedies undermine the statutory "compromise").

Accordingly, where Congress has expressly authorized specific remedies — as it has repeatedly done in the federal securities laws — this Court has held that courts should not override Congress's intent by implying additional remedies not expressly authorized by statute. Indeed, "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court

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10/ *Accord* Freedman & Sporkin, *The Securities and Exchange Commission's Enforcement Program: A Debate on the Enforcement Process*, 38 Wash. & Lee L. Rev. 781 (1981) (comments of Professor Freedman) ("The enforcement work of the Commission, at best, reflects an over-zealous insensitivity to individual liberties and the values of a free society, and, at worst, a deliberate pattern of serious and inexcusable violations of fundamental rights and elementary notions of fairness"); Kripke, THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE 51 (1973) (the SEC is prone to engage in "retribution against those who do not play the game of giving the staff an easy victory by negotiating a consent decree without trial"); Dent, *supra*, *Ancillary Relief*, 67 Minn. L. Rev. at 894, 925-926 (disgorgement remedies "can also produce error costs, including hindrance of capital formation. . . . One cannot meet these objections by assuming, in light of past behavior, that the Commission will restrain itself").

must be chary of reading others into it." *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, 19 (1979). In view of the comprehensive and precisely-calibrated scheme of remedies in the federal securities laws, courts should not assume that "Congress absent-mindedly forgot to mention" an additional remedy. *Id.* at 20.[11] In *Transamerica*, the Court held that express provisions for injunctive relief under the Investment Advisers Act, 15 U.S.C. § 80b-1, negated the existence of any implied private damage action. *Id.* As one commentator has observed, "[t]hat the express remedy also negates ancillary relief would seem to follow a fortiori." Dent, *supra, Ancillary Relief,* 67 Minn. L. Rev. at 891.

It is hard to imagine a system of rights and remedies more elaborate than that created by the securities laws. Over sixty specific sections or subsections expressly provide a host of remedies for violations of the securities laws in civil actions brought by private plaintiffs or the SEC, in administrative proceedings before the SEC, and in criminal prosecutions initiated by the Department of Justice.

As already discussed, the SEC may seek injunctive relief from the courts. It is specifically authorized, in many sections of the securities laws, to seek civil penalties from courts or to impose them administratively.[12] The securities laws give the SEC extensive authority to regulate and

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[11] *See also, Texas Indus., Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 644 (1981) (no implied right to contribution given existence of "detailed" and "specific" remedial provisions in antitrust laws); *Northwest Airlines*, 451 U.S. at 93-94 (1981) ("The comprehensive character of the remedial scheme expressly fashioned by Congress strongly evidences an intent not to authorize additional remedies"); *Middlesex County Sewerage Authority* v. *National Sea Clammers Assoc.*, 453 U.S. 1, 14 (1981) ("In view of these elaborate enforcement provisions it cannot be assumed that Congress intended to authorize by implication additional judicial remedies").

[12] 15 U.S.C. §§ 77*t*(d)(1), 77t(d)(2)(A), 78u(d)(3)(A), 78u-2(a), 78ff(b), 78ff(c)(2)(C), 80a-9(d), 80a-41(e), 80b-3(i), 80b-9(e)(2)(B). Indeed, Congress even established a multi-tiered system for determining the appropriate size of any civil penalties imposed under these sections. *See, e.g.*, 15 U.S.C. § 78u(d)(3)(B).

discipline persons who do business in the securities markets,[13] including the authority to seek court orders barring violators of the securities laws from serving as officers or directors of corporations.[14] In addition, through administrative proceedings, the SEC can seek cease and desist orders.[15]

Most importantly for purposes of this petition, and in sharp distinction to the authority granted to it in civil enforcement actions, *in administrative proceedings* the SEC is specifically authorized by the securities laws *to seek disgorgement*.[16] Congress's decision to allow disgorgement in carefully-specified administrative proceedings in the Securities Enforcement Remedies And Penny Stock Reform Act of 1990, Pub. L. 101-429, 104 Stat. 931 (1990), makes clear that the text of the original 1934 Act did *not* authorize such a remedy under its general injunctive provisions. Congress's express listing of comprehensive remedies, therefore, implies the exclusion of a general disgorgement remedy, especially given the fact that Congress has provided for disgorgement in certain circumstances but not in others. It is particularly significant that the same provisions which provide for injunctive relief go on to state that serious wrongdoing should be referred to the Department of Justice for criminal prosecution. 15 U.S.C. §§ 77t(b), 78u(e). Nowhere has Congress granted the federal courts power to order the disgorgement of $1, much less $75 million, in a civil suit brought by the SEC. *See SEC* v. *Sloan*, 436 U.S. at 112 (where the SEC seeks "awesome power with a potentially devastating impact," a "clear mandate from Congress" is "necessary to confer this power").

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[13] *See, e.g.*, 15 U.S.C. §§ 78o(b)(4), 78o(b)(6), 78o(c)(4), 78o-4(c)(2), 78o-5(c)(1)(A), 78o-5(c)(1)(C), 78s(h), 80a-9(b), 80b-3(e), 80b-3(f).

[14] 15 U.S.C. §§ 77t(e), 78u(d)(2), 80a-35(a).

[15] 15 U.S.C. §§ 77h-1, 78u-3, 80a-9(f), 80b-3(k).

[16] 15 U.S.C. §§ 77h-1(e), 78u-1(e), 78u-3(e), 80a-9(e), 80a-9(f)(5), 80b-3(i)(4)(j), 80b-3(k)(5).

The judicially-created disgorgement remedy is, in effect, an attempt by judges to rewrite the already comprehensive federal securities laws to "improve" their functioning. But courts are ill-suited, as a matter of institutional and constitutional competence, to perform the investigation and balancing of interests necessary to craft a complex remedial scheme. *See Bush* v. *Lucas*, 462 U.S. 367, 389 (1983). The only sensible response to the SEC's demand for disgorgement power, and the only solution consistent with fundamental principles of separation of powers, is to send the SEC back to Congress to obtain a legislative judgment on the availability and appropriate range of disgorgement remedies in federal court, complete with congressionally-defined substantive and procedural safeguards which are missing here (*see infra* pp. 17-18).

Recent experience under other analogous statutes confirms the need for congressional review of controversial policy issues before recognizing the sweeping disgorgement remedy demanded by the SEC. For example, under the Federal Trade Commission Act, the Federal Trade Commission argued unsuccessfully that its "cease and desist" powers encompassed an implied power to seek restitution. *See Heater* v. *FTC*, 503 F.2d 321, 325 (9th Cir. 1974) (finding serious problems of fair "notice" to the defendant, particularly where the refund order ran against an individual who "only constructively received those funds" through a then-bankrupt corporation). Congress responded to this ruling by passing a new Section 19 of the FTC Act in the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act of 1974, 15 U.S.C. § 57b. Congress carefully considered a variety of dangers of abuse in such proceedings and set forth specific substantive and procedural safeguards and restrictions designed to assure fundamental fairness.

The completely undefined nature of the disgorgement remedy, which is a recent phenomenon in securities litigation, makes it an especially inappropriate candidate for judicial implication. Recognition of a disgorgement remedy, without a statutory basis, requires courts to make open-ended legislative decisions on a host of complex and controversial subjects. As one authority has observed, "there is not as yet

any really good working structure that defines what we mean by unjust enrichment." DOBBS ON REMEDIES 226 (1973). The Second Circuit's amorphous rule — that the contours of disgorgement are simply a matter of "discretion" — ignores the principle that Congress is best situated to make these policy judgments.

When courts create disgorgement remedies without guidance from Congress, they must themselves legislate on a host of policy issues:

• **What rules apply to the calculation of disgorgement?** Having found a violation, the courts below required disgorgement even of profits that were not traced to any unlawful conduct. App. 100a. The courts then required petitioner Brennan to disgorge these amounts even though he never received them. *Id.* at 101a. Would Congress have viewed this punitive use of disgorgement as appropriate?

• **Who gets the money?** The SEC stated repeatedly in the district court that it was not seeking disgorgement to compensate injured investors (*see supra* p. 5), thereby avoiding dismissal of its claim in light of the class settlement. *See e.g.*, *FTC* v. *AMREP Corp.*, 705 F. Supp. 119, 124 (S.D.N.Y. 1988) (agency pursuit of monetary relief for benefit of settled class barred by *res judicata*). Only after it obtained its award did the SEC profess that it was "not yet clear where the disgorged proceeds will go," adding that some funds may go to investors, while "some or all of the disgorged money may eventually go to the U.S. Treasury." SEC App. Br. 47-48. Would Congress have approved this speculative and uncertain form of disgorgement, especially of profits the defendant did not actually receive?

• **Does disgorgement include prejudgment interest?** Where Congress has made a policy decision that *post*judgment interest in civil cases should be calculated using a defined rate, but in contrast has not adopted a fixed statutory formula for calculating *pre*judgment interest, leaving it instead to the discretion of district court judges on a case-by-case basis, would Congress countenance the approach adopted in this case, namely the application of the

same enhanced rate of interest to each case regardless of the circumstances?

• **Are there any time limits on disgorgement?** Congress has provided express statutes of limitations for damages actions and for penalty proceedings. *See infra* pp. 28-29. Criminal fines also must be pursued within a statute of limitations. Would Congress have wanted the SEC to pursue disgorgement many years after the events in question, while interest accrues at a punitive rate?

• **Does the defendant get a jury trial?** By artificially engrafting the new "disgorgement" remedy on the "injunction" provisions of the securities laws, the courts below effectively nullified the jury trial right that ordinarily applies whenever the government seeks to impose a monetary penalty to achieve "deterrenc — the purpose avowedly served here. *See infra* pp. 27-28. Would Congress have viewed this massive sanction (which resulted in the bankruptcy of both the corporation and its owner) as an "equitable" remedy?

These are important policy issues, on which Congress should speak. Courts should not invent rules of decision on these points in contradiction of the express and comprehensive remedies that Congress actually prescribed. As noted by former SEC Commissioner Karmel, "it is incumbent on Congress to review and adapt its legislative directives, in order to avoid leaving what are, in effect, legislative tasks to the courts by default." Karmel, *supra*, at 194.

B. The Disgorgement Remedy Rests On An Outmoded Method of Statutory Interpretation And Threatens To Undermine Congress's Manifest Intent.

1. The irrelevance of generalized purpose. Judicial implication of a disgorgement remedy is the product of a now-discredited line of cases interpreting legislation in light of generalized statutory purpose rather than the actual language employed by Congress. The leading example of this outmoded approach to statutory interpretation is *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 433 (1964), in which this Court recognized an implied cause of action under Section 14(a) of the Securities Exchange Act of 1934, and in

doing so emphasized "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." The Court further stated that "[i]t is for the federal courts to adjust their remedies so as to grant the necessary relief where federally secured rights are invaded" and that "courts may use any available remedy to make good the wrong done." *Id.*

The *Borak* approach, on which *Texas Gulf Sulphur* and the implied disgorgement remedy rest, has in more recent years been soundly repudiated by this Court in favor of an approach that adheres to the words of the statute. Two cases are of particular importance. First, in *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979), this Court expressly rejected the reasoning behind *Borak* and *Texas Gulf Sulphur*, emphasizing instead that in determining whether a given remedy exists, a court's "analysis must begin with the language of the statute itself." In concluding that there was no implied private cause of action under Section 17(a) of the 1934 Act, the Court stated that "generalized references to the remedial purposes of the 1934 Act will not justify reading a provision 'more broadly than its language and the statutory scheme reasonably permit.'" *Id.* at 578 (*quoting SEC* v. *Sloan*, 436 U.S. 103 (1978)). The Court stated that the "ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." *Id.*

Thus, the disgorgement decision in *Texas Gulf Sulphur* can no longer be considered good law. While the court in *Texas Gulf Sulphur* relied upon "general equity powers under § 27 of the Act," 446 F.2d at 1307, in *Redington* this Court squarely held that "Section 27 grants jurisdiction to the federal courts and provides for venue and service of process. It creates no cause of action of its own force and effect; it imposes no liabilities. The source of plaintiff's rights must be found, if at all, in the substantive provisions of the 1934 Act . . . not the jurisdictional provision." 442 U.S. at 577. Furthermore, in *Redington*, this Court declined to create an implied monetary remedy because the statutory provision in question "is forward looking, not retrospective." *Id.* at 570. Of course, the injunctive provisions here at issue are similarly (and exclusively) "forward looking" in nature.

Any lingering doubts about the continued vitality of the "purpose" approach of *Borak* and *Texas Gulf Sulphur* were put to rest in *Central Bank of Denver* v. *First Interstate Bank of Denver*, 511 U.S. 164 (1994), where this Court repudiated decades of lower court decisions that had recognized an implied private right of action for aiding and abetting violations of Section 10(b). The Court stated that "the text of the statute," which nowhere provided for aiding and abetting liability, "controls our decision." 511 U.S. at 173. The Court rejected the argument that "a broad based notion of congressional intent" could support the imposition of aiding and abetting liability, *id.* at 180-81, and refused to equate congressional inaction with specific statutory authorization. *Id.* at 1453. *See also Board of Governors* v. *Dimension Financial Corp.*, 474 U.S. 361, 373-75 & n.7 (1986):

> Application of the "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard-fought compromises. Invocation of the plain purpose of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of Congressional intent.[17/]

[17/] *Touche Ross* and *Central Bank* are among a long line of cases — in the securities law context and beyond — in which this Court has adhered strictly to statutory language, regardless of the broad remedial purposes that can be imputed to the legislation at issue. *See, e.g., Dunn* v. *CFTC*, 117 S. Ct. 913, 916 (1997) (in "apply[ing] the statute as Congress wrote it," Court found trading in off-exchange foreign currency options to be exempt from regulation); *SEC* v. *Sloan*, 436 U.S. 103, 118 (1978) (SEC not statutorily authorized to issue series of orders suspending trading in stock based upon single set of events); *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 472 (1977) ("language of 10(b)" requires more than mere breach of fiduciary

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2. Congress's specific intent. Confirming the statute's plain language, the legislative history counsels strongly against the implication of a disgorgement remedy. In passing the 1933 and 1934 Acts during the depression, Congress deliberately attempted to strike a balance that would protect investors while avoiding burdens on business that were inconsistent with economic recovery. *See, e.g.*, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 3 (1934) (the 1934 Act was "conceived in a spirit of the truest conservatism"). It is not surprising therefore, that, as detailed above, Congress focused on a limited, well-defined and precisely-calibrated set of remedies. The House Committee report lists four separately enumerated remedies, including suits by purchasers to protect their own rights, criminal prosecutions, and revocation of the registration of securities. As to injunctive relief, the report is explicit: "The government may *stop further or threatened fraud or misrepresentation by injunction* in the district courts." *Id.* (emphasis supplied). *Accord* S. Rep. No. 792, 73d Cong., 2d Sess. 22 (1934) (emphasis supplied) (the bill "authorizes the Commission to sue in United States courts *for an injunction against threatened violation*"). The focus is forward looking; there is no mention of a disgorgement remedy. Nor can broad ancillary remedies, such as disgorgement, be deemed part of the legislation on the basis of any "tradition of ancillary relief in administrative law in 1933-1934 for the obvious reason that federal administrative law did not exist to any significant degree at that time." Dent, *supra*, *Ancillary Remedies*, 67 Minn. L. Rev. at 926.[18]

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[17](...continued)
duty); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976) (regardless of statute's "remedial purposes," statutory language does not permit liability on the basis of negligence).

[18] In an earlier era of statutory interpretation, this Court sometimes construed statutory authorizations of injunctive relief as also encompassing limited restitutionary remedies. But it consistently recognized the inappropriateness of doing so where implication of a new remedy would upset the comprehensive and balanced array of remedies prescribed by Congress. *E.g.*, *Porter* v. *Warner Co.*, 328 U.S. 395, 402-03 (1946) (simple (continued...)

II. BY ALLOWING DISGORGEMENT TO BE USED AS A PENALTY, THE SECOND CIRCUIT HAS CREATED AN INTER-CIRCUIT CONFLICT ON AN IMPORTANT STATUTORY ISSUE

When courts proceed to invent sweeping new remedies, as they have with disgorgement, they must also (as we have explained) prescribe rules determining the amount of recovery, the proper recipients, the limitations periods for bringing suit, the interest rate for prejudgment interest, and the role of juries. The great deference shown by courts to the SEC, as reflected in the opinions below, means that there are few effective checks on the Commission's ability to determine such issues. While this case emphatically demonstrates that such policy decisions are better left to Congress entirely, if this Court determines that disgorgement is an appropriate implied remedy without statutory authorization, this case also demonstrates the compelling need for the Court to define the scope of the remedy. The Second Circuit's decision removes any meaningful limitations on disgorgement, transforming it from an equitable remedy to a penalty of massive proportions. The failure of the Second Circuit to limit disgorgement to the illicit gains actually received by petitioner Brennan not only creates a split with every other court that has addressed the issue, but also has far-reaching adverse consequences.

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[18]/(...continued)
"return" of funds is authorized where the act does not "expressly or impliedly preclude[] a court from ordering restitution . . . [t]his is not a situation where a statute created a right and has provided a special and exclusive remedy, thereby negativing any jurisdiction that might otherwise be asserted"); *Mitchell* v. *Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 291 (1960) (authorizing simple "reimbursement" of lost wages absent a "clear" indication or "inescapable inference" that Congress intended other remedies to be exclusive); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 391 (1970) (recognizing an implied private remedy where Congress proscribed certain conduct and made unlawful contracts "void," but acknowledging the inappropriateness of additional judge-made remedies where Congress has "meticulously detailed the remedies available").

A. The Panel's Affirmance Of An Order Requiring Brennan To Disgorge The Gains Of Another Person Is An Unprecedented Departure From Settled Law.

1. The punitive nature of the order. The Second Circuit's decision should be reviewed by this Court because it creates significant uncertainty as to how a disgorgement award may be determined — removing (for the first time in any reported case) important limitations that keep the *equitable remedy* from becoming a *penalty*. In affirming the $75 million disgorgement award against Brennan, the decision below violated the fundamental principle — heretofore applied in every court to address the issue — that the SEC's disgorgement remedy may reach only the illicit profit a defendant *actually receives*. *See SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) ("The court's power to order disgorgement extends only to the amount with interest by which a defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment"); *accord SEC* v. *Bilzerian*, 29 F.3d 689, 696 (D.C. Cir. 1994); *Hately* v. *SEC*, 8 F.3d 653, 656 (9th Cir. 1993); *SEC* v. *Washington County Utility District*, 676 F.2d 218, 227 (6th Cir. 1982). To the extent an order of disgorgement goes beyond the amount that a defendant actually receives, the order no longer can be considered an equitable remedy but instead constitutes a form of punishment inflicted for deterrent purposes, a result decidedly at odds with traditional principles of equity. *See Estate of Pidcock* v. *Sunnyland Am., Inc.*, 726 F. Supp. 1322, 1340 (S.D. Ga. 1989) ("disgorgement extends only to the profit a defendant actually received").[19/]

19/ *See SEC* v. *Graystone Nash, Inc.*, 25 F.3d 187, 193 (3d Cir. 1994), holding that the district court erred in ordering defendants to disgorge $60 million, while precluding the individual defendants from offering evidence of how much they actually received from a corporate defendant. *See also SEC* v. *World Gambling*, 555 F. Supp. 930, 931 (S.D.N.Y.), *aff'd mem.*, 742 F.2d 1440 (2d Cir. 1983), holding that no matter how extensive a defendant's participation in the fraud at issue, "he should not be required to disgorge what he did not receive." Requiring disgorgement of the full amount of profit from each of the defendants — regardless of what they each

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Especially in light of the Second Circuit's status as the "mother court" of federal securities litigation, *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting), this decision legitimates a sweeping and improper *expansion* of the scope of the disgorgement remedy. Unless corrected by this Court, the Second Circuit's decision, which departs markedly from *all* prior precedents, threatens to enlarge the reach of this judge-made remedy beyond all appropriate bounds.

The SEC identified no case authorizing such a sweeping application of the disgorgement remedy in its brief on appeal, was unable to do so when questioned during oral argument, and cited no case on point in its post-argument submissions to the panel. In nonetheless affirming the decision below, the court of appeals erroneously relied on prior cases holding that a district court has discretion in calculating the precise amount of disgorgement. *E.g.*, *SEC* v. *Patel*, 61 F.3d 137, 139 (2d Cir. 1995) (the amount of disgorgement "need only be a reasonable approximation of profits causally connected to the violation"). That discretion, however, relates to the calculation of how much an individual has actually received: it is not a license to order one individual to disgorge the gains of another. None of the cases cited by the Second Circuit (or by the SEC in its brief) involves the disgorgement of profits from an individual who demonstrated at trial that he never received them.

The dangers of the Second Circuit's decision are concretely illustrated by this case. Although the compensation Brennan actually received from the alleged fraud was undisputed, the district court's disgorgement award did not stop there. Brennan's total compensation from First Jersey between 1982 and 1985 that is traceable to the allegedly illegal transactions was less than $1 million. App. 228a. Nevertheless, the district court ordered Brennan personally to disgorge the entire $22.3 million in profits earned by First Jersey on those transactions, plus more than $53 million in prejudgment interest. *Id.* at 223a. The SEC

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[19]/(...continued)
actually received — "would constitute a fine, not disgorgement." *Id.* at 935.

made no allegation, and the district court made no finding, that First Jersey lacked a separate existence of its own.[20/] As noted previously, this staggering award forced Brennan into bankruptcy.

The penal nature of this disgorgement order was greatly magnified by the additional award of $53 million in prejudgment interest. Not only was Brennan required to disgorge millions of dollars he never received, but he also was required to pay interest on those phantom profits at a punitive rate — as if he were a person who had failed to pay taxes to the federal government. In contrast to the Second Circuit's ruling, other circuits consistently have held that in each case the district court must carefully balance the equities and articulate a rationale for selecting a particular rate of prejudgment interest. *See Knapp* v. *Ernst & Whinney*, 90 F.3d 1431, 1441 (9th Cir. 1996); *Booker* v. *Taylor Milk Co.*, 64 F.3d 860, 868 (3d Cir. 1995); *Anixter* v. *Home-Stake Prod. Co.*, 977 F.2d 1549, 1554 (10th Cir. 1992). That rule is especially important in cases such as this one, in which prejudgment interest covers a significant number of years. *Anixter*, 977 F.2d at 1554. By affirming the award of $52,689,893.99 in prejudgment interest, the Second Circuit inappropriately jettisoned these traditional requirements in favor of a simple rule — the SEC is awarded whatever rate it asks for, all to advance the "deterrent" or penal impact of the disgorgement award. App. 41a.

2. Erroneous policy justifications for the penalty. Faced with the undisputed fact that Brennan had received only 1/75th of what the district court ordered him to disgorge, the Second Circuit rationalized the district court's

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[20/] Before a party may "pierce" the corporate veil and hold a shareholder liable for obligations of the corporation, he "bears the burden of proof and must demonstrate the misuse of the corporate form and the necessity of disregarding it in order to do equity." *Department of Labor* v. *Berlanti*, 481 A.2d 830, 832 (N.J. Super. Ct. App. Div. 1984). Courts rely on several factors, such as the failure to observe corporate formalities, in order to determine whether the shareholder used the "corporation as his personal business conduit," thereby depriving the corporation of a separate existence of its own. *Walensky* v. *Jonathan Royce Int'l, Inc.*, 624 A.2d 613, 618 (N.J. Super. Ct. App. Div. 1993).

decision on two alternative grounds, neither of which is consistent with prior law and each of which, if followed, would yield an uncontrolled and wholly inappropriate expansion of the disgorgement remedy.

First, the Second Circuit held that Brennan could be ordered to disgorge the profits of First Jersey because he theoretically could have withdrawn — but never did — additional profits from First Jersey as its owner.[21/] There is no precedent for this novel theory of disgorgement. The Second Circuit's decision means that any controlling shareholder (or group of shareholders) would be subject to disgorgement liability for illicit gains of a corporation on the basis that, regardless of the historical facts, the shareholder "could have" arranged to receive higher dividends or otherwise could have withdrawn more money from the corporation. Ordering disgorgement from a defendant of what he hypothetically might have received, rather than what he actually received, radically alters the law of disgorgement. By not requiring any meaningful relationship between the disgorgement and the actual amount of unjust enrichment, the judgment below plainly exacts a forbidden penalty.

The Second Circuit's alternative rationale for affirming the order requiring Brennan to disgorge all of First Jersey's profits — joint and several liability — also marks a significant expansion of the disgorgement remedy and confirms the penal character of this order. The policy goal of joint and several liability, which makes each defendant responsible for the entire amount of damages awarded, is to ensure that injured persons are made whole. *See World Gambling*, 555 F. Supp. at 931. That rationale, however, does not apply here because, as the court of appeals and the SEC acknowledged (App. 39a), disgorgement is "unlike an

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21/ Even under this theory, Brennan could never have withdrawn First Jersey's gross profits of $22.4 million. First Jersey had necessary business expenses, including payroll, rent, sales commissions, and normal overhead. Moreover, the Second Circuit entirely overlooked the fact that Brennan was not enriched by the full amount of compensation he received because he paid taxes on those amounts. *See* Ellsworth, *supra*, 1977 Duke L.J. at 661 (failure to deduct tax payments from disgorgement award exacts an impermissible penalty).

award of damages." Disgorgement is a "deterrent," not a means to compensate injured First Jersey customers, all of whom previously released and settled their claims. Tr. 555, 1059, 1143-45. Indeed, at trial the SEC expressly disclaimed the intention of using any disgorged funds to compensate investors; the entire award, it said, will be remitted to the U.S. Treasury. Tr. 1059. Not only did the Second Circuit overlook the limited purpose behind joint and several liability, but it failed to articulate any other equitable basis for saddling Brennan with the burden of disgorging money he never received. *See World Gambling*, 555 F. Supp. at 931 ("To the extent that joint liability requires payment of a sum greater than the profits unlawfully obtained by the fraudulent transaction, it is a penalty and therefore improper"). The Second Circuit's permissive approach to disgorgement ignores the principle that the SEC's statutory powers are not, and should not be, infinitely elastic; they do not create "a panacea for every type of problem which may beset the marketplace." *Sloan*, 436 U.S. at 116.

B. The Lack Of Any Meaningful Limitations On The Disgorgement Remedy Has Far-Reaching Adverse Consequences.

By engrafting a new "deterrent" remedy upon a statutory provision designed to afford only preventive equitable relief, the SEC now has a ready means to deprive securities law defendants of their right to trial by jury, and to avoid the application of any statute of limitations. These adverse effects — which Congress could not have intended — confirm the need to constrain disgorgement orders which manifestly inflict a penalty.

1. Erosion of jury trial rights. The expanded disgorgement remedy endorsed by the Second Circuit enables the SEC to subvert a basic constitutional protection by the simple expedient of labeling actions for a civil penalty as "disgorgement" proceedings. Since true disgorgement proceedings are characterized as an equitable remedy, a defendant is not entitled to a jury trial. By contrast, SEC actions seeking civil penalties are legal in nature and require that a defendant be afforded a trial by jury should he so desire. *See Tull* v. *United States*, 481 U.S. 412, 423 (1987)

(explaining the traditional distinctions determining whether a jury is available based upon the legal or equitable nature of the claim). Where, however, as in this case, the disgorgement remedy has been expanded to include profits never received by the defendant, the traditional line between equitable "disgorgement" and a legal "penalty" has been crossed by a wide margin. *See Tull*, 481 U.S. at 424-25 (holding that a $22 million judgment was so large that it could not be characterized as incidental to equitable relief, and was therefore a penalty that required trial by jury). Here, this basic constitutional protection vanished altogether based on the fiction that the SEC was seeking a conventional equitable remedy.

It is the character of the relief that determines whether it is equitable or legal and, consequently, whether a right to trial by jury exists. *Woodell* v. *Brotherhood of Elec. Workers*, 502 U.S. 93, 97 (1991). Where the relief sought is plainly "deterrent" or punitive, as here, the action is legal in nature and the Seventh Amendment preserves the right to a trial by jury. *See Tull*, 481 U.S. at 424-25. Nevertheless, because the SEC was able to secure $75 million under the guise of "disgorgement," petitioner Brennan was deprived of that basic constitutional right.

2. Nullification of the statute of limitations. By dressing this massive penalty in the sheep's clothing of an ordinary equitable remedy, the SEC also overrode all protections afforded by congressionally-prescribed statutes of limitations. The Second Circuit refused to apply *any* statute of limitations, and, in fact, did not even address petitioners' detailed arguments on that issue. Where, as discussed above, a securities law defendant has been compelled to "disgorge" profits that he never received (plus interest), and where the defendant has already settled all claims brought by persons who allegedly suffered injury, it is plain that the "deterrent" order sought by the government is neither an equitable nor a compensatory order. Thus, although labeled as "disgorgement," the action seeks a penalty and should be time-barred with respect to claims that arose more than five years before the action was commenced under the statute of limitations applicable to civil penalty actions, 28 U.S.C. § 2462. *See Johnson* v. *SEC*, 87 F.3d 484, 491-92 (D.C.

Cir. 1996) (applying 28 U.S.C. § 2462). If the court below applied the five-year statute of limitations prescribed by Congress for penalty actions, *the SEC's allegations regarding half of the transactions at issue in this case would have been time-barred.* Nonetheless, through the expanded disgorgement remedy endorsed by the Second Circuit in this case, the SEC is now able to avoid *any* limitations period simply by denominating claims that in substance seek civil penalties as claims for disgorgement.[22/]

The policies of the statute of limitations and the securities laws should not be so easily subverted: certainty and repose both are indispensable to the efficient functioning of the securities markets. *See In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537, 1546 (3d Cir. 1988) (*en banc*). The SEC's claim that Congress would have declined to impose *any* time limit whatsoever on disgorgement actions, especially those involving tens of millions of dollars and a decade of prejudgment interest, is not a plausible one. *See Lampf, Pleva, Lipkind, Prupis & Petrigrow* v. *Gilbertson*, 501 U.S. 350 (1991) (imposing a limitation period of one year from discovery and an outer limit of three years from accrual for private claims under Section 10(b) of the 1934 Act). Ultimately, whether the SEC should have the ability, as in this case, to obtain disgorgement with interest at the highest possible rate in stale proceedings is an issue properly left for Congress, not the courts.

22/ The fact that an award is labeled "disgorgement" is not dispositive: "the determining consideration concerns whether the amount so labeled serves a remedial or punitive function." *SEC* v. *Lorin*, 869 F. Supp. 1117, 1121-22 (S.D.N.Y. 1994), *rev'd on other grounds*, 76 F.3d 458 (2d Cir. 1996); *see also Department of Revenue* v. *Kurth Ranch*, 511 U.S. 767, 784 (1994) (state tax considered to be "punishment"); *United States* v. *Halper*, 490 U.S. 435, 448 (1989) ("[A] civil as well as a criminal sanction constitutes punishment when the sanction as applied in the individual case serves the goals of punishment."); *SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (any disgorgement award that exceeds the amount of the defendant's personal gain would amount to a penalty).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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Dated: May 23, 1997

Supreme Court, U.S.
FILED

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OFFICE OF THE CLERK

No. _____

In the Supreme Court of the United States

OCTOBER TERM, 1996

FIRST JERSEY SECURITIES, INC. AND
ROBERT E. BRENNAN,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 1154, 1155
August Term 1995
(Argued: April 10, 1996)
(Decided: December 10, 1996)
Docket Nos. 95-6192, -6194

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

FIRST JERSEY SECURITIES, INC.

and ROBERT E. BRENNAN,

Defendants-Appellants.

Before: LUMBARD and KEARSE, *Circuit Judges*, and MORAN, *District Judge*.[1]

Appeal from a judgment of the United States District Court for the Southern District of New York, Richard Owen, *Judge*, holding defendants liable for federal securities law violations, appointing special agent to determine whether additional violations were committed, enjoining future violations, and ordering

[1] Honorable James B. Moran, of the United States District Court for the Northern District of Illinois, sitting by designation.

disgorgement of $22,228,099 in unlawful gains, plus $52,689,894 in prejudgment interest. *See* 890 F. Supp. 1185 (1995).

Affirmed in part; reversed in part.

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KEARSE, *Circuit Judge*:

Defendants First Jersey Securities, Inc. ("First Jersey" or the "Firm"), and Robert E. Brennan appeal from a judgment entered in the United States District Court for the Southern District of New York following a bench trial before Richard Owen, *Judge*, holding defendants liable for violations of § 17(a) of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. § 77q(a) (1994); § 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b) (1994); and Securities and Exchange Commission ("SEC" or the "Commission") Rule 10b-5, 17 C.F.R. § 240.10b-5 (1995), in the sale, repurchase, and resale of six securities. The district

court ordered defendants jointly and severally to disgorge the sum of $22,288,099, plus $52,689,894 in prejudgment interest; enjoined them from further securities laws violations; and appointed a special agent (the "Special Agent") to determine whether, in 1982-1987, defendants had committed securities law violations beyond those proven at trial. On appeal, defendants contend principally that the present action was barred by res judicata and that the court erred in imposing liability and in fashioning relief. Brennan also challenges, *inter alia*, the district court's order that he be held jointly and severally liable for the entire amount of disgorgement ordered by the court. For the reasons below, we reverse so much of the judgment as appointed the Special Agent, and in all other respects we affirm.

I. BACKGROUND

The present action was commenced by the SEC in 1985, based on allegations that, beginning in November 1982 and continuing into 1985, First Jersey, with Brennan at the helm, had employed a massive and coordinated system of fraudulent practices to induce its customers to buy certain securities from the Firm at excessive prices unrelated to prevailing market prices, resulting in defendants' gaining more than $27 million in illegal profits from their fraudulent scheme. The following facts were found by the district court to have been established at trial and are not challenged by defendants.

A. First Jersey's Business Practices

First Jersey was founded in 1974 as a discount broker-dealer specializing in the underwriting, trading, and distribution of low-priced securities. The vast majority of securities traded by First Jersey were sold primarily in the over-the-counter market and not listed on any national exchange. By 1985, the Firm operated 32 branch offices throughout the United States and 36 offices in foreign countries, and had more than 500,000 retail-customer accounts. It employed approximately 1,200 salespersons or "registered representatives." In hiring such sales personnel, First Jersey typically sought individuals who had no prior experience in the securities business.

A First Jersey registered representative's working month consisted of a three-part cycle. The first two weeks of the month were spent "cold calling," *i.e.*, telephoning individuals who were not customers of the Firm and whose names were found in general directories, to identify persons who might be interested in purchasing a security recommended by the Firm. The second phase began around the third week of the month, when the manager of the branch informed the sales personnel that a recommendation would be forthcoming from the research department in about a week; the manager at that time gave the salespersons no specific information about the security. The salespersons then renewed contacts with their potential customers, informing them that the Firm's research department was about to make a recommendation and seeking to determine how much money a customer would be willing to invest in a First Jersey-recommended security.

The third phase of the cycle began during the fourth week of the month, with the branch manager conducting a sales meeting to disclose to the branch's salespersons the name of the recommended security; only one security at a time was recommended to a given branch; but not all of the branches received the same recommendation. The branch manager relayed information received from the Firm's main office in New York about the recommended security, including its price and the sales commission to be paid. The branch manager also gave the salespersons a scripted sales pitch, which they were required to record and were expected to use virtually verbatim in offering the security to customers. The sales pitch usually described the security as reflecting "a spectacular turnaround situation."

At various times, salespersons were given written materials that included First Jersey research reports, annual reports of the recommended company, and newspaper articles. There generally was no discussion, however, of negative factors such as risks inherent in a recommended security. Further, salespersons were discouraged from conducting independent research on Firm-recommended securities and were not even permitted to contact the Firm's research department about a security without getting permission from the branch manager. In addition, for reasons that will become apparent below, the salespersons at any given branch

were prohibited from discussing the Firm's recommendations for their branch with salespersons from other First Jersey branches.

Following the sales meeting, salespersons were to spend the remainder of the month attempting to sell the recommended security—and only that security—to their clients. Salespersons who chose not to sell the recommended security were berated and often censured by First Jersey's management. Further, the compensation structure placed a premium on selling the recommended security. If a client bought the recommended security, the salesperson received a commission in the range of 5%-10% of the price. If the client instead bought a different security, the salesperson received a commission of one percent or less. And for the client's sale of a security, the salesperson received no commission at all. When clients sold previously purchased First Jersey-recommended securities back to the Firm, they were urged to roll the proceeds over into another First Jersey-recommended security. As a result of the commission structure, First Jersey salespersons rarely recommended that their customers purchase any securities other than the one currently recommended by the Firm.

First Jersey received the vast majority of its revenues from trading securities for its own accounts, including securities that it had underwritten. Between November 1982 and August 1986, First Jersey acted as the sole underwriter for at least 31 new issues of securities that were sold in "units" consisting of a combination of shares of common stock and warrants that could later be redeemed for common stock. It was the Firm's regular practice to have sales personnel in a group of branch offices first sell a particular unit and then, shortly thereafter, urge the clients who had purchased those securities to resell them to First Jersey at a slight profit to the client. Then the Firm split the repurchased units and sold the components separately through other branch offices to new customers, at a significantly higher total price than the Firm had paid the original customer.

For example, in November 1982, First Jersey was the underwriter for 1,100,000 units of Sovereign Chemical and Petroleum Products, Inc. ("Sovereign"). Each unit consisted of three shares of common stock and one warrant; the units were not to be split prior to May 1, 1993, except at First Jersey's option.

On November 9, 1982, the first day of the offering, First Jersey oversold, selling to customers of certain of its branches approximately 1,700,000 units at the offering price of $3 per unit, for a total price of $5,100,000. Within days, First Jersey bought back more than 1,300,000 units, paying $3.50 per unit; it immediately split the units into their components and priced each of the three shares of stock at $2.25-$2.50 and the warrant at $1. Thus, a unit purchased by First Jersey for $3.50 could be promptly resold, after the unbundling of the components, for a total of approximately $8. First Jersey immediately resold more than 3,000,000 shares of Sovereign common stock and 1,000,000 Sovereign warrants to customers of Firm branches other than the branches that had originally sold and repurchased the units. First Jersey's profit on the resale of the Sovereign securities totaled $5,172,292. The same pattern was followed with respect to securities of five other issuers: Quasar Microsystems, Inc. ("Quasar"), QT & T, Inc. ("QT & T"), Rampart General, Inc. ("Rampart"), Sequential Information Systems, Inc. ("Sequential"), and Trans Net Corp. ("Trans Net").

The Firm did not inform the salespersons who were to suggest that customers resell recommended units to First Jersey that the Firm would immediately split the repurchased units into their component securities and sell the components separately for more than twice what it paid the selling customer. The salespersons who thereafter sold the individual components were not advised of the Firm's original underwriting of the unit. Nor were they provided with a prospectus or advised of the risks disclosed in the prospectus. The reason that First Jersey sales personnel were forbidden to discuss the recommendations for their branch with their counterparts at other First Jersey branches was to prevent them from learning that some branches were buying back units cheaply while other branches were selling components from those units to other Firm clients at inflated markups.

At all relevant times, Brennan was a director and the 100% owner of First Jersey. Between January 1982 and August 1985, he was its president; in September 1985, he became its chairman and chief executive officer. In his capacity as sole shareholder and president or chief executive officer, Brennan met regularly with the

heads of First Jersey's departments, made the final decisions concerning which securities the Firm would underwrite, and frequently participated in negotiations concerning the prices at which First Jersey sold the securities. Brennan testified at trial that he periodically received reports on First Jersey's positions in various securities, regularly reviewed the research reports issued to the branch offices, and "typically was aware of most of the research reports that went out, if not all." He also participated in meetings at which the Firm's pricing policies were formulated, and he regularly discussed the Firm's compliance, *see* Part III.C.2. below, with rules promulgated by the National Association of Securities Dealers, Inc. ("NASD"). Although at trial, Brennan denied any wrongdoing, he did not indicate that the actions challenged here were unauthorized acts of other executives.

B. The Present Litigation

The SEC commenced the present action in October 1985, alleging that the above practices constituted illegal markups and frauds on First Jersey's customers in violation of § 17(a) of the 1933 Act, § 10(b) of the 1934 Act, and Rule 10b-5. The complaint sought disgorgement of the profits gained from those practices, as well as injunctive and other equitable relief.

Defendants moved to dismiss the complaint on the grounds, *inter alia*, that it was barred by principles of res judicata in light of an administrative proceeding initiated by the SEC in May 1979 and settled in November 1984. The district court rejected the res judicata defense, noting that the administrative proceeding, discussed in greater detail in Part II below, concerned First Jersey's trades in a certain group of securities during the 1970s, whereas the present case involved its trades in different securities in the 1980s. The court concluded that the two sets of claims were not identical for purposes of res judicata.

A 41-day bench trial was held in 1994, at which the court received voluminous documents and extensive testimony, including live, videotaped, or transcribed deposition testimony of 12 former First Jersey salespersons called by the SEC, 22 former First Jersey branch managers and salespersons called by defendants, and several First Jersey officers, including Brennan. In a written opinion dated

June 19, 1995, reported at 890 F. Supp. 1185, the court concluded that the SEC had

> overwhelmingly proven that defendants First Jersey and Brennan with respect to the sales and resales of securities involved herein to First Jersey customers violated § 17(a), § 10(b), and Rule 10b-5 in that with scienter, they deliberately used fraudulent devices in those transactions. Specifically, First Jersey's sales practices were intended by defendants to operate, and did operate, as a pervasive fraud on First Jersey's hundreds of thousands of retail customers....

890 F. Supp. at 1209. The court found that in selling and repurchasing the unit securities, and reselling the components, First Jersey violated those provisions in two ways, to wit, by withholding material information from customers and by making excessive markups in the prices of the unbundled securities.

As to the first type of violation, the court found that defendants engaged in "a massive and continuing fraud on its customers," *id.* at 1195, both on the initial group of First Jersey customers, *i.e.*, those who resold to the Firm at a small profit without being informed that the units were about to be unbundled and sold at a much higher price, and on the second group of First Jersey customers, *i.e.*, those who purchased the unit components for prices that, in light of the price of the units, were artificially inflated. The court found that the goal

> of the scheme was to leave both the customers selling securities back to [First Jersey] (usually "units") and the customers purchasing securities from [First Jersey] (usually "unit" components), completely ignorant of the way in which First Jersey had in all other respects dealt in those securities, and as to the sales of the components, First Jersey's salesmen knew almost nothing about the companies, and knew they were selling to buyers who knew even less.

Id. The court found that

> [d]efendants First Jersey's and Brennan's conduct[ ] was entirely purposeful. It was planned this way. This is clear not only from the patterned and repeated format of the trading, but also from the simple programmed structure of First Jersey's marketing system. Defendants orchestrated every facet of First Jersey's branch office network to ensure that the firm's underwritings and other low-priced stock recommendations were sold *when* they wanted—*where* they wanted—at prices determined not by market forces but by First Jersey itself. Its salesmen themselves, with minimal information and the incentive of earning as much as ten percent (plus a five percent managers' override) on a customer's investment dollar, were accordingly able to sell to the firm's customers securities at illegal mark-ups up to as much as 150 percent.

Id. (emphasis in original) (footnote omitted).

The court concluded that, particularly in light of First Jersey's domination and control of the markets for the securities in question, its conduct constituted securities fraud under precedents dating back half a century.

As to the second type of violation, the district court found that "the evidence overwhelmingly established that the defendants wilfully and deliberately violated established law forbidding excessive markups" in the sale price of the securities. *Id.* at 1197. The court stated that:

> [t]he starting point in determining the legality or illegality of a broker's markup on a sale of stock is the establishment, from the best available evidence, of the prevailing market price.... This is a factual, not a legal search.

Id. Concluding that First Jersey was not a "market maker" in any of the securities because it did not "hold[ ] itself out to the broker-dealer community as standing ready to purchase and sell that security at particular quoted bid and asked prices," *id.*, the court

quoted the applicable SEC guidelines for determining prevailing market price as follows:

> The best evidence of the prevailing market price for a broker-dealer who is not making a market in the security is that dealer's contemporaneous cost of acquiring a security.... Where ... a security is not only inactively traded between dealers, but a competitive market does not exist because that market is 'dominated' by a single dealer, the use of market maker sales or quotations is likely to be impractical or misleading. In such a 'dominated' market, the best evidence of prevailing market price is the dealer's contemporaneous cost, which is either the price that the dealer paid to other dealers, or the price that the dealer paid to its retail customers to acquire the security, after an adjustment that allows the dealer a markdown on purchases from customers.

Id. at 1197-98 (footnote omitted) (quoting Zero-Coupon Securities Release No. 34-24368, 38 S.E.C. Docket 158, 1987 WL 112328 (Apr. 21, 1987)). The court found that First Jersey dominated and controlled the markets for the six securities at issue because the vast majority of the transactions in those securities were conducted by First Jersey. The court further noted that although the Firm made some purchases in the interdealer market, those trades were insignificant because their volume was tiny in comparison to the Firm's "massive retail trading" in those securities with its own customers. 890 F. Supp. at 1200. Having determined that First Jersey was not a market maker in any of those securities, the court concluded that, under the SEC guidelines, the best measure of the securities' prevailing market price was the Firm's cost of acquiring the units from its customers.

To calculate the contemporaneous cost of the units' components, given the prevailing market price of the units, and hence the markup enjoyed by First Jersey, the court adopted an allocation formula proposed by the SEC, which the court described using the following example:

> If a unit consists of two shares of common and one warrant, and First Jersey buys [the unit] back from a customer for $1 and then sells the common at $.75 a share and the warrant at $.50, the First Jersey sales price for a unit equivalent is [a total of $1.50 for the common plus .50 for the warrant, for a total of $2]. Thus, under the allocation formula, 1 share of common is 37.5% of the unit equivalent and 1 warrant is 25%. Applying that percentage to the acquisition cost of the unit, each share of common has a cost basis of $.375....

890 F. Supp. at 1200 n.23. Whether the focus be on a single share of the common stock (essentially purchased for $.375 and resold for $.75) or on all of the elements comprised by the unit (purchased for $1 and resold for a total of $2), First Jersey's markup would have been 100%. In the securities at issue here, the court concluded that First Jersey enjoyed markups of up to 150%.

The court noted that First Jersey did not call either its head trader or its head of sales to testify as to how the Firm arrived at its markups. Nor had the expert who testified on First Jersey's behalf posed that question to anybody at First Jersey. The court concluded that the markups were plainly excessive.

The district court ruled that Brennan was primarily liable with First Jersey for the securities violations committed by the Firm. The court based its finding on trial evidence that

> showed plainly that Brennan was a "hands-on" manager who was intimately involved in the operations of First Jersey, including all significant decisions regarding the firm's underwriting, retail sales and trading activities. Brennan signed every one of the underwriting agreements at issue in this case and admitted that he "typically" participated in the key decision to split "units" into their component securities.
>
> In his trial testimony Brennan ... never denied knowing that First Jersey had repeatedly underwritten "units," and bought the units back

> from its customers, and had broken up the units, and resold the components to other customers without disclosing the price at which it had repurchased the units. To the contrary, he defended those transactions, taking the position that First Jersey's massive and repeated oversales and repurchases of units were, essentially, accidental, and that the firm's unit repurchases and the prices at which they were acquired, were not material to the customers who bought the components. .

Id. at 1201. The court observed that, as the 100% owner of First Jersey during the relevant period, Brennan received periodic reports on the Firm's positions in the securities it traded and, with regard to the Firm's commission policy, that "he could have made any decision he wanted to," *id.* (internal quotation marks omitted). The court concluded that Brennan's control over First Jersey's activity made him liable as a principal for the Firm's fraudulent conduct.

The court also concluded that the evidence of First Jersey's violations and Brennan's position and conduct established Brennan's joint and several liability for the violations as a "controlling person" of the Firm under § 20(a) of the 1934 Act, 15 U.S.C. § 78t(a) (1994). It noted that "as president, chief executive officer, and sole shareholder of First Jersey, Brennan possessed control over every aspect of First Jersey's operations," 890 F. Supp. at 1202. Applying the burden-shifting scheme articulated by this Court in *Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980), the court held that the burden had shifted to Brennan to show that he had in good faith "maintained and enforced a reasonable and proper system of supervision and internal control over sales personnel," 890 F. Supp. at 1202 (internal quotation marks omitted), and hence should not be held liable for violations by the Firm. The court found that Brennan had not met that burden. Reviewing the evidence as to the compliance procedures adopted by First Jersey, described in greater detail in Part III.C.2. below, the court found that those procedures were more cosmetic than real, and that they "were never intended for more than appearances should an occasion such as this arise." *Id.* at 1203.

As relief for the proven violations, the court ordered, *inter alia*, that First Jersey and Brennan disgorge the profits gained by the Firm as a result of the frauds with respect to the six securities at issue, and pay prejudgment interest on those sums from the dates of the gains through the entry of judgment — a period of up to 12+ years. The court calculated the Firm's unlawful profits with respect to each issuer as follows:

Issuer	First Jersey's Profit
QT&T	$ 581,659
Quasar	6,302,659
Rampart	2,110,617
Sequential	12,111,384
Sovereign	5,172,292
Trans Net	1,009,488
Total	$27,288,099

Id. at 1211. Giving defendants credit for a $5 million payment they made in January 1987 to settle a class action based on transactions in some of these securities, *see id.* at 1211 n.35, the court ordered defendants to disgorge $22,288,099 in unlawful profits. After excluding interest on the $5 million from the date of the payment, *see id.* at 1212, the court ordered defendants to pay prejudgment interest in the total amount of $52,689,894, *see* Judgment dated July 17, 1995.

In addition, the district court permanently enjoined defendants from further violations of the securities laws, finding that it was "highly likely" that such future violations would occur. 890 F. Supp. at 1210. This finding was based in part on defendants' history of "[b]rushes" with regulatory agencies in the securities industry, *see* Part IV.C. below, which had already resulted in censures, fines, and suspensions, and injunctions. The court observed that, while First Jersey had sold most of its retail branches in 1987, the Firm continued to operate on a day-to-day basis and that at the time of trial Brennan was still the 100% owner of First Jersey's stock, as well as the sole or majority shareholder of a number of other corporations "through which he has the power

to and does continue his activities in the securities field." 890 F. Supp. at 1208.

Finally, noting the evidence of violations during a two-year period with respect to the securities of Sovereign, Rampart, Quasar, Trans Net, Sequential, and QT & T, and noting "the background of defendants' sales and business practices," the district court stated that it was "thoroughly convinced under any standard that the particular violations proved at trial are in all probability only the tip of the iceberg." *Id.* at 1212. The court stated that it would therefore appoint a Special Agent to determine whether in 1982-1987 there had been other violations as well and to recommend to the court further disgorgements. The court premised this order on its general equity powers:

> Under the law, "[o]nce the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy." *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d [1082, 1103 (2d Cir. 1972)]; *see also SEC* v. *Posner*, 16 F.3d 520, 521 (2d Cir. 1994). Accordingly, I conclude that under the Court's general equitable powers, a special agent should be appointed to examine the records of defendant First Jersey Securities for the period from November 1, 1982 through January 31, 1987, for the purpose of determining whether there exists [*sic*] excessive markups and/or markdowns charged to [Firm] customers, beyond those proved at trial. Should any such excessive markups or markdowns be determined, the special agent shall recommend to the Court that defendants disgorge and pay over, as the Court may direct, all illegally-obtained profits.

890 F. Supp. at 1212-13.

Judgment was entered accordingly, and this appeal followed.

On appeal, defendants do not challenge the court's factual findings as to First Jersey's business practices, but they make a variety of challenges to the court's rulings as to procedure, liability and relief. They contend (1) that the district court should have dismissed the action on the ground of res judicata; (2) that the court erred in concluding (a) that First Jersey's markups were excessive and violated the securities laws, and (b) that Brennan should be held personally liable for those violations; and (3) that the court abused its discretion in (a) ordering disgorgement, (b) calculating prejudgment interest, (c) issuing a permanent injunction, and (d) appointing a special agent. For the reasons that follow, we find error only in the appointment of the Special Agent. In all other respects, we affirm.

II. THE RES JUDICATA DEFENSE

Defendants contend that the present action was barred by principles of res judicata as a result of a settlement agreement with the SEC in November 1984 ("1984 Settlement"). That agreement settled an administrative action commenced by the SEC in 1979 (the "1979 Proceeding"), along with an unrelated civil injunctive action that had been brought by the SEC in the United States District Court for the Southern District of New York in 1983, alleging federal securities laws violations by Brennan and First Jersey in the purchase and sale of securities of Geosearch, Inc. in 1980 (the "Geosearch action"). The principal focus of defendants' res judicata claim is the administrative proceeding.

In the 1979 Proceeding, the SEC charged that First Jersey and a number of its principals, including Brennan, had violated the federal securities laws in transactions that occurred between 1975 and 1978. The SEC alleged that First Jersey and Brennan had, *inter alia*, "employed manipulative and deceptive devices and contrivances and employed devices, schemes and artifices to defraud" by selling seven securities, including certain securities of Sequential and Rampart, at excessive markups above the prevailing market price for the securities. (1979 Order for Public Proceeding and Notice of Hearing ("1979 Notice") at ¶ M.) It alleged that the prices that First Jersey charged to its customers were "the result of [the Firm's] domination and control of the market in which such securities were traded." (*Id.*)

Proceedings before an SEC administrative law judge on these charges began in November 1979. The hearings were adjourned in October 1980 to allow the parties to pursue settlement negotiations. The negotiations eventually resulted in the 1984 Settlement, pursuant to which the SEC agreed to dismiss both the 1979 Proceeding and the Geosearch action with prejudice. In exchange for that dismissal, Brennan and First Jersey consented to (a) the entry of a permanent injunction prohibiting them from committing future violations, and (b) the appointment of an independent securities consultant to monitor First Jersey's sales practices. A Final Judgment of Permanent Injunction by Consent was entered in the Geosearch action, enjoining Brennan and the firm from "bidding or purchasing for any account in which it has a beneficial interest, any security which is the subject of such distribution." *SEC* v. *First Jersey Securities, Inc.*, 83 Civ. 0483(MP) (S.D.N.Y. Judgment Nov. 20, 1984). The consent, executed by Brennan, stated

> that the Commission ha[d] represented to First Jersey that upon the entry of this Permanent Injunction by Consent the Commission will forthwith enter an Order, in the form agreed to by the parties, dismissing, with prejudice, the Order for Public Proceedings issued by the Commission on May 17, 1979, ... and that the Commission will not institute an administrative proceeding against First Jersey or Robert E. Brennan on the basis of the annexed Permanent Injunction by Consent, or the Permanent Injunction by Consent of Robert E. Brennan filed concurrently herewith,

but that the Commission had otherwise made First Jersey no promises. *Id.* (Consent dated November 20, 1984, at 9-10).

The present action was commenced by the SEC in October 1985, alleging frauds by First Jersey and Brennan beginning in November 1982 and continuing into 1985. Defendants sought summary dismissal on the basis that the SEC was aware of at least some of the transactions at issue here prior to settling the 1979 Proceeding and that these claims could have been litigated during the 1979 Proceeding. They argued that "the stock manipulation

scheme alleged in the current SEC Complaint is the same as the scheme alleged in both the 1979 Notice and during the 1979-80 hearings"; that the "material issues raised in the SEC's current Complaint are in many respects identical to the issues raised by the SEC in the 1979 Order and the 1979-80 hearings"; and that "[t]he only difference ... between the issues raised by the prior 1979 Order and the issues raised by the current SEC Complaint is that the stock transactions in the current SEC Complaint cover a later time period." (Affidavit of Franklin D. Ormsten dated November 26, 1985, ¶ 5.) Defendants pursue their res judicata defense on appeal. We conclude that the district court properly rejected it.

Under the claim preclusion branch of res judicata, "[a] final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action." *Federated Department Stores, Inc.* v. *Moitie*, 452 U.S. 394, 398 (1981).

> Simply put, the doctrine of res judicata provides that when a final judgment has been entered on the merits of a case, [i]t is a finality as to the claim or demand in controversy, concluding parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.

Nevada v. *United States*, 463 U.S. 110, 129-30 (1983) (internal quotation marks omitted). The doctrine may be applied to judgments of administrative agencies acting in an adjudicative capacity. *See, e.g., Astoria Federal Savings & Loan Association* v. *Solimino*, 501 U.S. 104, 107-08 (1991); *United States* v. *Utah Construction & Mining Co.*, 384 U.S. 394, 421-22 (1966); *Greenberg* v. *Board of Governors of the Federal Reserve System*, 968 F.2d 164, 168 (2d Cir. 1992).

With respect to the determination of whether a second suit is barred by res judicata, the fact that both suits involved essentially the same course of wrongful conduct is not decisive, *see, e.g., Prime Management Co.* v. *Steinegger*, 904 F.2d 811, 815 (2d Cir.

1990); nor is it dispositive that the two proceedings involved the same parties, similar or overlapping facts, and similar legal issues, *see, e.g., NLRB* v. *United Technologies Corp.*, 706 F.2d 1254, 1259-60 (2d Cir. 1983). A first judgment will generally have preclusive effect only where the transaction or connected series of transactions at issue in both suits is the same, that is "whe[re] the same evidence is needed to support both claims, and whe[re] the facts essential to the second were present in the first." *NLRB* v. *United Technologies Corp.*, 706 F.2d at 1260; *see also Nevada* v. *United States*, 463 U.S. at 128-30 (court must determine whether same "cause of action" is sued on); *Lawlor* v. *National Screen Service Corp.*, 349 U.S. 322, 329 (1955) ("a prior judgment is res judicata only as to suits involving the same cause of action"); *Woods* v. *Dunlop Tire Corp.*, 972 F.2d 36, 38 (2d Cir. 1992), *cert. denied*, 506 U.S. 1053 (1993); *Saud* v. *Bank of New York*, 929 F.2d 916, 919 (2d Cir. 1991).

If the second litigation involved different transactions, and especially subsequent transactions, there generally is no claim preclusion. *See, e.g., Lawlor* v. *National Screen Service Corp.*, 349 U.S. at 328 (no *res judicata* bar to claim for anticompetitive conduct occurring subsequent to first suit); *Greenberg* v. *Board of Governors of the Federal Reserve System*, 968 F.2d at 168-70 (same re different financial transactions); *Prime Management Co.* v. *Steinegger*, 904 F.2d at 816 (same re subsequent breaches of contract); *NLRB* v. *United Technologies Corp.*, 706 F.2d at 1260 (same re subsequent labor conflicts over same type of employee activity at different times and places, involving different employees). For example, when a contract was to be performed over a period of time and one party has sued for a breach but has not repudiated the contract, res judicata will preclude the party's subsequent suit for any claim of breach that had occurred prior to the first breach-of-contract suit, but will not preclude a subsequent suit for a breach that had not occurred when the first suit was brought. *See id.; Restatement (Second) of Judgments* § 24 comment d.

These principles confirm the correctness of the district court's rejection of defendants' res judicata defense in the present case. The 1979 Proceeding was initiated by an administrative

complaint that charged violations with respect to First Jersey's transactions in seven securities in 1975-1979. The evidentiary hearing on those charges began in 1979 and continued into 1980. At the time the SEC filed its charges and throughout the period of the hearing, the transactions at issue here had not yet occurred. Plainly, the SEC could neither have included its present claims with respect to transactions occurring in 1982-1985 in its 1979 administrative charge nor proven those transactions in a hearing that did not extend past 1980. The claim that First Jersey defrauded customers in the sale, purchase, and repurchase of certain securities in 1975-1979 is not the same as the claim that First Jersey defrauded customers in the sale, purchase, and repurchase of other securities in 1982-1985.

If a defendant engages in actionable conduct after a lawsuit is commenced, the plaintiff may seek leave to file a supplemental pleading to assert a claim based on the subsequent conduct. *See* Fed. R. Civ. P. 15(c). But he is not required to do so, and his election not to do so is not penalized by application of res judicata to bar a later suit on that subsequent conduct:

> The scope of litigation is framed by the complaint at the time it is filed. The rule that a judgment is conclusive as to every matter that might have been litigated does not apply to new rights acquired pending the action which might have been, but which were not, required to be litigated.... Plaintiffs may bring events occurring after the filing of the complaint into the scope of the litigation by filing a supplemental complaint with leave of the court, ... but there is no requirement that plaintiffs do so.

Los Angeles Branch NAACP v. *Los Angeles Unified School District*, 750 F.2d 731, 739 (2nd Cir. 1984) (internal quotation marks omitted) (emphasis added), *cert. denied*, 474 U.S. 919 (1985); *see also Manning* v. *City of Auburn*, 953 F.2d 1355, 1360 (11th Cir. 1992) (decision whether or not to attempt to assert claims that arose subsequent to the filing of the action "is optional for the plaintiff; the existence of the doctrine of res judicata does not make the filing of supplements mandatory").

Defendants assert that the SEC's present claims "could have been alleged" or "might have been raised" in the 1979 Proceeding (First Jersey brief on appeal at 14, 24), but they cite no authority holding that a claim that arose after a suit was commenced but prior to judgment is barred by res judicata if not pursued through a supplemental pleading. Their reliance on a statement in *Hawkins* v. *Risley* that "[t]he date of judgment, not the date of filing, controls the application of res judicata principles," 984 F.2d 321, 324 (9th Cir. 1993) (internal quotation marks omitted), is misplaced. The Hawkins court was not concerned with the question of claims that arose during the pendency of a lawsuit; the quoted statement was made in response to the plaintiff's argument that res judicata did not apply because the judgment be given preclusive effect concluded an action that had been commenced later than the still-pending action in which it was to be given that effect. The holdings in *Lawlor* v. *National Screen Service Corp.* and *Teltronics Services, Inc.* v. *L M Ericsson Telecommunications, Inc.*, 642 F.2d 31, 35 (2d Cir.) ("Teltronics"), *cert. denied*, 450 U.S. 978 (1981), likewise provide no support for defendants' position. Though the opinion in *Lawlor* included the statement that "judgment precludes recovery on claims arising prior to its entry," 349 U.S. at 328, that statement was dictum insofar as it might be applied to claims that arose after a complaint was filed, for in *Lawlor*, all of the claims raised in the second action were based on acts that occurred either prior to the commencement of the first action or subsequent to the entry of judgment in that action. And the reference in *Teltronics* to the *Lawlor* language, *see* 642 F.2d at 36, was likewise dictum, since *Teltronics* involved a second suit that, though more detailed, asserted precisely the same claims as the first, *see id.* at 35 ("In this case the same parties, the same cause of action and the same facts form the basis of the second complaint.").

We reject the notion that the SEC had a procedural obligation to expand the scope of the 1979 Proceeding to assert claims that First Jersey engaged in unlawful acts and transactions after the commencement of that proceeding or be forever barred from challenging that subsequent conduct. A government agency charged with enforcing the law has no greater obligation than does a private plaintiff to file a supplemental pleading with regard to a

defendant's subsequent acts. The notion that the agency must either perpetually expand its charges to pursue new unlawful acts in an ongoing proceeding or lose the ability to pursue the persistent violator for misdeeds between the start and conclusion of the proceeding would in effect confer on the miscreant a partial immunity from liability for future violations. Such a notion is both antithetical to the regulatory scheme and inconsistent with the doctrine of res judicata.

Finally, there is no basis in the record for defendants' additional argument that litigation of the present issues was foreclosed by the 1984 Settlement itself. Though litigation settlements can resolve issues not raised in the pleadings, any such resolution depends on the intent of the parties to the settlement, *see, e.g., Greenberg* v. *Board of Governors of the Federal Reserve System*, 968 F.2d at 168, and the record contains no suggestion of any such intent here. Attorneys for defendants corresponding with the SEC shortly before the 1984 Settlement wrote that the settlement should include only the issues raised in the 1979 Proceeding and the Geosearch action. Defense counsel advised the Geosearch court that the agreement would settle "all outstanding matters with the SEC on the following terms: .... The SEC will dismiss *all allegations contained in*" the 1979 Proceeding (Letter of Andrew J. Maloney to Judge Milton Pollack dated November 7, 1984, at 1-2 (emphasis added)); the allegations in the 1979 Proceeding did not include First Jersey's 1982-1985 acts. And the consent executed by defendants stated that, except for agreeing to dismiss the 1979 Proceeding and not to institute an administrative proceeding against First Jersey or Brennan on the basis of the injunction agreed to in the Geosearch action, the Commission had made them no other promises. The present action by the SEC was not barred.

III. LIABILITY

Section 17(a) of the 1933 Act makes it unlawful for any seller of securities, using the mails or an instrumentality of interstate commerce, directly or indirectly

> (1) to employ any device, scheme, or artifice to defraud, or

> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a). Section 10(b) of the Exchange Act prohibits both sellers and buyers of securities, using the mails or an instrumentality of interstate commerce or the facility of a national securities exchange, from employing "any manipulative or deceptive device or contrivance in contravention of [SEC] rules and regulations." 15 U.S.C. § 78j(b). Rule 10b-5, promulgated under § 10(b), makes it unlawful

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

The proscriptions of § 10(b) and Rule 10b-5 were meant to be

> broad and, by repeated use of the word "any," are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments [including the 1933 Act] embrace a "fundamental purpose ... to substitute a philosophy

> of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.... Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes."

Affiliated Ute Citizens v. *United States*, 406 U.S. 128, 151 (1972) (footnote omitted). The basic aim of the antifraud provisions is to "prevent rigging of the market and to permit operation of the natural law of supply and demand." *United States* v. *Stein*, 456 F.2d 844, 850 (2d Cir.), *cert. denied*, 408 U.S. 922 (1972). The theory of a natural, unrigged market is that the "competing judgments of buyers and sellers as to the fair price of the security brings about a situation where the market price reflects as nearly as possible a just price." H.R. Rep. No. 1383, 73rd Cong., 2d Sess., at 11 (1934).

To this end, § 17(a) and Rule 10b-5 expressly prohibit misstatements and omissions as to facts that are material. A fact will be considered material within the meaning of these provisions "if there is 'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total" mix of information available.'" *In re Time Warner Inc. Securities Litigation*, 9 F.3d 259, 267-68 (2d Cir. 1993) (quoting *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976)) (interpreting § 10(b)), *cert. denied*, 114 S. Ct. 1397 (1994); *see SEC* v. *Rogers*, 790 F.2d 1450, 1458 (9th Cir. 1986) (interpreting § 17(a)). The materiality of an item of information is a mixed question of law and fact. *See, e.g., TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. at 450. The legal component depends on whether the information is relevant to a given question in light of the controlling substantive law. *See, e.g., Anderson* v. *Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). The factual component requires an inference as to whether the information would likely be given weight by a person considering that question. *See, e.g., TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. at 450.

In order to establish primary liability under § 10(b) and Rule 10b-5, a plaintiff is required to prove that in connection with the purchase or sale of a security the defendant, acting with scienter, made a material misrepresentation (or a material omission if the defendant had a duty to speak) or used a fraudulent device. *See, e.g., Brown* v. *E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1031 (2d Cir. 1993); *McMahan & Co.* v. *Wherehouse Entertainment, Inc.*, 900 F.2d 576, 581 (2d Cir. 1990), *cert. denied*, 111 S. Ct. 2887 (1991). Scienter, as used in connection with the securities fraud statutes, means intent to deceive, manipulate, or defraud, *see, e.g., Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 193 n.12 (1976); or at least knowing misconduct, *see, e.g., Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 382-83 (1983) (mere negligence not sufficient); *Wechsler* v. *Steinberg*, 733 F.2d 1054, 1058 (2d Cir. 1984). Whether or not a given intent existed, is, of course, a question of fact. *See, e.g., id.* at 1059.

With respect to § 17(a)(1), essentially the same elements must be established in connection with the offer or sale of a security. *See generally Zerman* v. *Ball*, 735 F.2d 15, 23 (2d Cir. 1984) ("[G]iven the similarity of the text of § 17(a) of the 1933 Act to that of Rule 10b-5, we conclude that if a private right of action exists under § 17(a), [plaintiff] has stated a claim upon which relief may be granted against [defendant] under that section as well."); *Savino* v. *E.F. Hutton & Co.*, 507 F. Supp. 1225, 1231 (S.D.N.Y. 1981) ("Since Section 17(a), like Section 10(b), sounds in fraud, similar allegations are required to state a claim under that section."). Scienter, however, need not be established for the SEC to obtain an injunction under of §§ 17(a)(2) or (3). *See Aaron* v. *SEC*, 446 U.S. 680, 701-02 (1980).

A. First Jersey's Nondisclosure of Material Facts

The district court ruled, first, that First Jersey violated § 17(a)(1), § 10(b), and Rule 10b-5 by failing to disclose material facts to its customers with respect to, *inter alia*, the companies whose securities it was trading with them, the nature of the market for those securities, the Firm's control over that market, and the Firm's plans for immediate unbundling and resale of the repurchased securities at a far higher price than what it would pay to repurchase them. The court found that, by these nondisclosures,

defendants succeeded in perpetrating massive and pervasive frauds on First Jersey's hundreds of thousands of customers, and that defendants had acted with scienter in that they intentionally used fraudulent devices for the purpose of enabling First Jersey to charge excessive markups, knowing they were violating the law. Defendants do not challenge the court's findings of fact. (First Jersey brief on appeal at 5 ("We ... will assume that those factual findings were not clearly erroneous....").) Hence, for purposes of this appeal, defendants have conceded that they failed to make disclosures of facts that would have been important to their customers; that their nondisclosures were intended to, and did, defraud their customers; and that these intentional frauds were designed to facilitate the markups that they charged.

Defendants argue instead that the misrepresentations and omissions found by the court were legally irrelevant to the matter of whether or not their markups were excessive and to the relief granted and that their markups were not excessive. We disagree.

It has long been recognized that the character of the market for a given security is relevant in determining the application of §§ 17(a) and 10(b), and that a broker-dealer who creates a market in securities and sells the securities to its customers without disclosing the nature of that market violates those provisions. "It is of utmost materiality to a buyer ... to know that he may not assume that the prices he pays were reached in a free market; and the manipulator cannot make sales not accompanied by disclosures of his activities without committing fraud." *Halsey, Stuart & Co.*, 30 S.E.C. 106, 112 (1949). In *Norris & Hirshberg, Inc.* v. *SEC*, 177 F.2d 228, 232-33 (D.C. Cir. 1949), for example, the court found substantial evidence to support the SEC's finding that a broker-dealer violated §§ 17(a) and 10(b) when it failed to disclose to customers its general practice of acquiring large portions of the available issues of unlisted securities, selling them to its customers, buying them back, and then reselling them to the same and other customers. The SEC had concluded that the firm's manner of trading allowed it to fix the prices of the securities in a market largely unaffected by competition and that the noncompetitive nature of the market in which the securities were traded was a material fact that the firm had an obligation to reveal to its clients:

> Each of [the broker-dealer's] sales carried with it the clear—though implied—representation that the price was reasonably related to that prevailing in an open market.... Without disclosure fully revealing that the 'market' was an internal system created, controlled, and dominated by the [broker-dealer] that representation was materially false and misleading.

Norris & Hirshberg, Inc., 21 S.E.C. 865, 882 (1946), *aff'd*, 177 F.2d 228 (D.C. Cir. 1949); *see also Richard J. Puccio*, 59 S.E.C. Docket 1985, 1995 WL 419347, at *3 (July 10, 1995) (holding that broker violated the antifraud provisions by, *inter alia*, "crossing" customer orders or inducing one set of customers to purchase stocks sold by another set of customers without informing the first set of customers that he recommended the securities simply to find a buyer for the selling customers' securities); *S.T. Jackson & Co.*, 36 S.E.C. 631, 656 (1950) (finding that broker-dealers committed securities fraud by, *inter alia*, failing to advise clients that market for stock was "artificial, having been created and controlled by [the broker-dealers] for the purpose of profitably disposing of stock which they held or were to acquire").

When First Jersey repurchased the units at issue here and sold their component securities to its retail customers without disclosing either the fact that it created and maintained the markets for those securities or the nature of its sales practices, the Firm impliedly represented that the prices paid for those securities reflected their value in a competitive market. In fact, the market was created almost entirely by First Jersey's own activity, and the district court found that First Jersey's failure to disclose to customers of its respective branches that it was buying units cheaply from one set of customers and reselling at a 100-150% markup to another set of customers defrauded both groups of customers. First Jersey preserved its customers' ignorance of market conditions in part by maintaining the ignorance of its own sales representatives: sales personnel were provided with a sales script for the recommended securities and were discouraged from conducting independent research before selling a security. Customers who purchased component securities were never

informed that the securities had been issued in units, nor were they advised of the sale or purchase price of the units or provided with a prospectus for the unit offering. The record well supports the district court's finding that the intentional nondisclosures allowed the Firm to manipulate the market for the securities and to gain substantial profits for itself while depriving its customers of the ability to make an informed decision about the purchase or sale of the securities.

Accordingly, we reject defendants' contention that the court's first conclusion as to liability was irrelevant to the question of excessive markups. The fraudulent nondisclosures facilitated First Jersey's manipulation of the market and allowed the Firm to charge markups that were excessive.

B. First Jersey's Excessive Markups

In challenging the district court's ruling that the markups they charged were excessive, defendants contend that the court misunderstood both the role of a market maker in a security and the concept of liquidity, and that it therefore erred in looking to the retail prices at which First Jersey purchased units in order to determine the reasonableness of the markups in its resale of the components. We are unpersuaded.

Sales of securities by broker-dealers to their customers carry with them an implied representation that the prices charged in those transactions are reasonably related to the prices charged in an open and competitive market. *See, e.g., Charles Hughes & Co.* v. *SEC*, 139 F.2d 434, 437 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1944); *SEC* v. *Resch-Cassin & Co.*, 362 F. Supp. 964, 978 (S.D.N.Y.1973). Hence, a broker-dealer who charges customers retail prices that include an undisclosed, excessive markup violates § 17(a) and § 10(b) of the securities laws. *See Alstead, Dempsey & Co.*, 47 S.E.C. 1034, 1035 (1984); *see generally Norris & Hirshberg, Inc.* v. *SEC*, 177 F.2d at 232-33.

A markup is the difference between the retail price and the "prevailing market price" of the security. A securities firm that acts as a dealer is entitled to charge a reasonable markup on the wholesale price it pays for the security; under NASD rules, a reasonable markup is generally not more than 5% over the

prevailing market price. *See First Independence Group, Inc.* v. *SEC*, 37 F.3d 30, 32 (2d Cir. 1994) (citing NASD Rules, Section 4, Interpretation of the Board of Governors-NASD Markup Policy). An undisclosed markup of more than 10% above the prevailing market price has been held to constitute fraud *per se*. *See, e.g., Powell & Associates*, 47 S.E.C. 746, 748 (1982). In defining the prevailing market price of a security for purposes of calculating a dealer's markup, the SEC distinguishes between dealers who are market makers and those who are not, between markets that are competitive and those that are not, and between controlling dealers that make significant purchases in the interdealer market and those that do not.

A market maker in a security is defined in the 1934 Act as a broker-dealer that holds itself out in the interdealer market as being ready to purchase and sell that security for its own account on a regular and continuous basis. *See* 15 U.S.C. § 78c(a)(38) (1994). For market makers, markups in the security "may be computed on the basis of the contemporaneous prices *charged by* the firm or other market makers in actual sales to other dealers or, if no such prices are available, on the basis of representative *asked* quotations." *Alstead, Dempsey & Co.*, 47 S.E.C. at 1036 (emphases added).

If a broker-dealer is not a market maker, the best evidence of a security's prevailing market price is generally the price at which dealers in a security trade with one another, *i.e.*, the "wholesale" price. *See generally Orkin* v. *SEC*, 31 F.3d 1056, 1063-64 (11th Cir. 1994); *F.B. Horner & Associates* v. *SEC*, 994 F.2d 61, 63 (2d Cir. 1993) (per curiam); *Barnett* v. *United States*, 319 F.2d 340, 344 (8th Cir. 1963). If the market for the security is competitive, the markup may be determined on the basis of the prices that other broker-dealers quote; where, however, a dealer controls or dominates the market, the best evidence of the security's prevailing market price is the price the controlling or dominating dealer actually paid. *See Robert B. Orkin*, 51 S.E.C. 336, 340 (1993) (where market is dominated and controlled by dealer, prices paid by others are not best measure of prevailing market value), *aff'd*, 31 F.3d 1056 (11th Cir. 1994).

To determine whether a firm dominated the market for a particular security, the Commission considers a number of factors, including (1) whether the firm was an underwriter of the initial public offering of the security and sold a substantial percentage of the offering to its own customers; (2) whether the firm was a market maker in the secondary market for the stock and traded a significant amount of the volume in the secondary market; and (3) the number of other market makers in the stock and their percent of total trading volume as compared to the trading volume of the firm in question. *See Meyer Blinder*, 50 S.E.C. 1215, 1218 n.14 (1992). "Where a firm sells all but a small portion of an initial public offering to its own retail clients, and the remainder is fragmented among several other dealers," the underwriter normally "control[s] wholesale pricing to such an extent as to preclude an independent market from arising .... [and is] empowered to set prices arbitrarily." *George Salloum*, 59 S.E.C. Docket 39, 1995 WL 215268, at *2 (Apr. 5, 1995) (internal quotation marks omitted); *see also Robert B. Orkin*, 51 S.E.C. at 337 (where broker-dealer "effected the vast majority of the retail trades and executed most of the few wholesale trades that occurred," the broker-dealer dominated market for security).

If a controlling dealer makes few or no purchases in the interdealer market, or if the volume of trading among dealers is insignificant in comparison to the controlling dealer's retail trades, the best evidence of that security's prevailing market price is generally the retail market price that the dealer paid. *See Meyer Blinder*, 50 S.E.C. at 1224 n.38; *see George Salloum*, 59 S.E.C. Docket 39, 1995 WL 215268, at *3. In *George Salloum*, for example, the SEC found insignificant a dealer's purchases on the wholesale market in determining prevailing market price where the dealer acquired, as to one security, 546,900 shares of stock from its customers for resale and only 18,100 shares wholesale from other dealers, and, as to a second security, 250,000 shares of stock from its customers and only 13,600 shares from dealers. The Commission found that, because the dealer had "manipulat [ed] ... the markets for these securities and ... the volume of the shares acquired [from its retail customers] was so significant" that the best evidence of the prevailing market price for the securities was the price that the dealer paid to its customers, adjusted by an imputed

markdown of 10%. *Id.* at *3-4; *cf. Meyer Blinder*, 50 S.E.C. at 1224 n.38 ("We believe that actual purchases from retail customers, adjusted for the markdowns charged, are far more probative evidence of the prevailing market price for an integrated dealer that dominates and controls the market for a security because they indicate the price the market maker is willing to pay for the security."); *W.T. Anderson Co.*, 39 S.E.C. 630, 636-37 (1960) (using retail purchases to establish prevailing market price where dealer's sale and repurchase from customers "creat[ed] whatever market existed in the[ ] stocks except for a few transactions by other brokers in [one disputed] stock").

In the present case, we conclude that the district court correctly found that First Jersey was not a market maker with regard to the subject securities. The Firm did not hold itself out in the interdealer market as ready to purchase these securities at a particular price; to the contrary, the evidence presented at trial showed that First Jersey made only minor purchases of the securities on the interdealer market, conducting the vast majority of its transactions with its retail customers.

The district court also correctly concluded that First Jersey dominated and controlled the markets in the six securities at issue here. First Jersey acted as the sole underwriter of the initial units of those securities, the majority of which were sold by the Firm to its own customers. For example, in the November 1982 underwriting of and transactions in Sovereign securities, described in Part I.B. above, First Jersey was the underwriter for the public offering of 1,100,000 units, each of which included three shares of stock; First Jersey actually sold some 1,700,000 units to its customers; it repurchased 1,300,000 of the units, and after splitting the units into their components, it resold approximately 3,000,000 shares of Sovereign common stock from the split units to another group of its customers. The court's finding that First Jersey's control over the market for Sovereign securities was nearly complete was amply supported not only by these massive sales to the Firm's own customers but also by the dearth of trades between the Firm and other dealers or among other dealers *inter sese*. In contrast to its trading in millions of units and shares with its own customers, First Jersey sold only 1,000 shares of Sovereign

common stock to other broker-dealers; First Jersey made no purchases of Sovereign stock in the interdealer market. As for other broker-dealers, between November 19 and December 1, 1982, the "pink sheets," *i.e.*, NASD's published interdealer quotation lists showing prices bid by broker-dealers wishing to purchase a particular security and prices asked by broker-dealers wishing to sell, listed only two broker-dealers with respect to the Sovereign common stock and only one with respect to the Sovereign units. The dealer listed for the Sovereign stock sold only 9,300 shares. The dealer listed for the units quoted no price, and no Sovereign units were purchased or sold by any broker-dealer other than First Jersey. In the period following the initial offering of the Sovereign units, therefore, First Jersey controlled 100% of the "buy" side and 99.7% of the "sell" side of the Sovereign common-stock market. The trial evidence showed a similar pattern with respect to the other securities at issue in this litigation. Because as to these securities First Jersey was not a market maker but dominated the market for these securities, and there were few or no trades either with or among other dealers, the district court, in determining their prevailing prices and calculating First Jersey's markups, correctly relied on the prices the Firm actually paid its customers to acquire the securities.

We are not persuaded by defendants' contention that the court erred in looking to the prices First Jersey paid for the units as evidence of the market value of the component securities because the prices of the units reflected a discount due to their illiquidity. Defendants' own expert acknowledged that since First Jersey had the sole power to repurchase and unbundle the units, it unilaterally determined their liquidity. First Jersey could thus determine, without consideration of a competitive market price, the price at which the securities were bought and sold. The district court found further that defendants never considered the liquidity of the units in underwriting the units, repurchasing the units, or selling their component securities, and indeed found that even prior to the date of the public offering it was First Jersey's plan to repurchase shortly after the offering, promptly unbundle, and resell at huge markups. The court was entitled to infer that the price of the units reflected First Jersey's domination and control over the market for the securities, and not a discount reflecting illiquidity.

In sum, we see no error in the district court's findings that First Jersey sold securities to its customers at prices that included excessive markups, that it was able to do so in part because of its nondisclosures to customers as to the nature of the market and the Firm's control of the market, and that the purpose of the nondisclosures was to facilitate the excessive markups. The district court correctly concluded that this conduct violated §§ 17(a) and 10(b) and Rule 10b-5.

C. Brennan's Personal Liability

In addition to disputing the liability of the Firm itself, Brennan contends that even if First Jersey committed fraud, he should not have been held personally liable for any violation, either as a primary violator of the securities law or as a controlling person under § 20(a) of the 1934 Act. We disagree.

1. Primary Liability

"Any person or entity ... who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under [federal securities law], assuming all of the requirements for primary liability ... are met." *Central Bank* v. *First Interstate Bank*, 511 U.S. 164, 191 (1994) (emphasis omitted). Primary liability may be imposed "not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration." *Azrielli* v. *Cohen Law Offices*, 21 F.3d 512, 517 (2d Cir. 1994).

The evidence presented at trial sufficed to establish that Brennan had knowledge of First Jersey's frauds and participated in the fraudulent scheme. The district court found that "the whole point of the scheme" undertaken here, 890 F. Supp. at 1195, which required some branches to purchase and others to resell, and forbade each group to talk to the other, was to keep customers in the dark, and was coordinated from First Jersey headquarters. The magnitude of First Jersey's scheme and the degree of oversight needed to coordinate the activities carried out by dozens of branch offices throughout the United States, and hundreds, if not thousands, of sales representatives, supports the district court's determination that the illegal activity could only have occurred at

the direction of First Jersey's upper-level management. The court found that Brennan was engaged in the purposeful planning of the pattern and repeated format of trading in which the respective branch offices engaged and that he "orchestrated every facet of First Jersey's branch office network." 890 F. Supp. at 1195.

These findings are permissible inferences from the evidence, much of it from Brennan's own testimony, as to Brennan's stake and active role in the Firm. He was sole owner. Throughout the relevant period, he was a director and was either its president or its chief executive officer. In addition to receiving after-the-fact reports on the various securities sold by the branch offices, Brennan, *inter alia*, chose which securities First Jersey underwrote, was generally consulted before the units were split into their component parts, had a large measure of control over the "home office," which established the Firm's sales policies, and regularly consulted with heads of the Firm's six departments, including First Jersey's head trader, who priced the securities sold by the Firm.

Brennan's reliance on *Universal Heritage Investments Corp.*, 47 S.E.C. 839 (1982), for the proposition that only supervisory, and not primary, liability, should have been imposed on him is misplaced. *Universal Heritage* involved a finding that one branch of a brokerage firm had engaged in unlawful activity, and the SEC ruled that the firm's executive vice president was not primarily liable because, though he was responsible for the daily operation of the firm, there was insufficient evidence that he was actually aware of the misconduct of the branch office in question, and hence there was an insufficient basis for a finding that he had "intentional[ly] and knowing[ly] acquiesce[d]" in the illegal activity. *Id.* at 844. The findings in the present case that Brennan was aware of and "was intimately involved in" the decisions as to unit-splitting and pricing, 890 F. Supp. at 1201, and that he orchestrated First Jersey's balkanization of its branches in order to keep customers in the dark, are supported by the record and distinguish this case from *Universal Heritage* and other cases in which an individual escaped primary liability.

In light of the evidence presented at trial with regard to Brennan's hands-on involvement in the pertinent decisions, we

conclude that the trial court did not err in finding that Brennan knowingly participated in First Jersey's illegal activity and that he should be held primarily liable for its violations of the securities laws.

2. Controlling Person Liability

Even if Brennan were not to be held primarily liable for his participation in First Jersey's fraudulent activity, the district court properly ruled that he was liable for violations of § 10(b) and Rule 10b-5 as a controlling person under § 20(a) of the 1934 Act. Section 20(a) provides that

> [e]very person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78(t). Since § 20(a) is available as an enforcement mechanism to "any person to whom such controlled person is liable," and the 1934 Act includes government agencies in the definition of "person," *see* 15 U.S.C. § 78c(9), we have upheld the SEC's authority to pursue an enforcement action under § 20(a). *See SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801, 812 (2d Cir. 1975). *Contra SEC* v. *Coffey*, 493 F.2d 1304, 1318 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

In order to establish a *prima facie* case of controlling-person liability, a plaintiff must show a primary violation by the controlled person and control of the primary violator by the targeted defendant, *see Marbury Management, Inc.* v. *Kohn*, 629 F.2d at 715-16, and show that the controlling person was "'in some meaningful sense [a] culpable participant[ ] in the fraud perpetrated by [the] controlled person[ ],'" *Gordon* v. *Burr*, 506 F.2d 1080, 1085 (2d Cir. 1974) (quoting *Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973) (en banc)). Control over a primary violator may be established by showing that the defendant possessed

"the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 240.12b-2.

Once the plaintiff makes out a *prima facie* case of § 20(a) liability, the burden shifts to the defendant to show that he acted in good faith, *see Marbury Management, Inc.* v. *Kohn*, 629 F.2d at 716; *Gordon* v. *Burr*, 506 F.2d at 1086, and that he "did not directly or indirectly induce the act or acts constituting the violation," 15 U.S.C. § 78t. To meet the burden of establishing good faith, the controlling person must prove that he exercised due care in his supervision of the violator's activities in that he "maintained and enforced a reasonable and proper system of supervision and internal control[s]." *Marbury Management, Inc.* v. *Kohn*, 629 F.2d at 716.

As discussed in Part III.A. and B. above, the district court properly found that First Jersey violated the 1934 Act; and for the reasons discussed in Part III.C.1. above, there can be no question that Brennan was a controlling person with respect to First Jersey. Hence, in order to escape controlling-person liability, Brennan had the burden of showing that he did not induce the Firm's violations and that he maintained and enforced a reasonable and proper system of supervision and internal control over the pertinent personnel. The district court permissibly found that he did not carry that burden.

In an effort to show that First Jersey had in place internal procedures for assuring compliance with price markup rules established by the SEC and NASD during the pertinent period, defendants presented the testimony of Frederick A. Eyerman, First Jersey's vice president in charge of compliance. Eyerman stated that the markups on First Jersey's principal sales to its customers were established by the Firm's trading department. The compliance department reviewed the Firm's trades by looking at the interdealer quotes in the NASD pink sheets. But Eyerman acknowledged that First Jersey's procedures did not require the Firm to calculate markups for securities for which it controlled the market any differently from the way it calculated markups for securities for which the Firm did not control the market. Eyerman further testified that in order to determine whether the Firm was

complying with industry regulations, he looked for "red flags," such as large differences between the Firm's acquisition price of a security and the price the Firm charged to its customers for the security. But he conceded that he did not look at all sales and that he determined the Firm's acquisition cost for a security by looking only at transactions that occurred on the very day the Firm sold the security. Needless to say, given that there were virtually no trades other than those conducted by First Jersey, and that First Jersey's resales occurred a few days after its repurchases, Eyerman's measurement of the Firm's markup on a given day by looking only at sales that occurred on that day left him unable to detect any discrepancies. This pattern of conduct amply justified the district court's conclusion that First Jersey's purported compliance efforts were more cosmetic than real.

Further, with respect to First Jersey's dealings with its customers, the record showed that the Firm gave its sales representatives little information about proper procedures or about the securities they were hawking. Former First Jersey salespersons testified, for example, that training manuals typically did not contain information about the risks inherent in the type of securities sold by First Jersey and, in any event, the manuals were not distributed to all sales personnel. The registered representatives were not permitted to do research on their own; there was no published information on the securities in question. Nor were they allowed, without permission from the branch manager, to contact the Firm's research department for information. Rather, they were scripted on what to say. The court found that "[v]irtually all of the twelve former First Jersey salesm[e]n who testified for the SEC described the 'script.'" 890 F. Supp. at 1189. The branch manager would come out of his office and tell the sales representatives to clear their telephones so that they could hear and write down the script verbatim. The message "was repeated several times until we had it correct in our notes." *Id.* at 1190 (quoting a former First Jersey salesman). The information, taking up 1-1½ pages on a legal pad, was basically the same for every stock. "'[T]hey all started the same way. I mean, he gave us, you know, spectacular turnaround situation, was a line that was almost in every presentation.'" *Id.* at 1189 (quoting a former First Jersey salesman).

A number of former First Jersey sales representatives further testified that the Firm periodically distributed questionnaires to sales personnel, ostensibly to provide the Firm's management with information concerning compliance with industry rules and regulations. However, the completed questionnaires with regard to the Firm's practices were replete with misinformation that was at times provided by management itself. For example, the questionnaire asked whether First Jersey always required sales representatives to learn their customers' financial objectives and circumstances prior to making any purchase or sale recommendation, and a former branch manager testified that that question was never answered in the negative. *Id.* at 1202 n.25. In fact, however, the Firm imposed no such requirement. It did not advise sales representatives as to the appropriate length of time a security should be held by a customer, or about the mix of securities appropriate to customers with certain income levels and financial needs, and it did not instruct its salespersons to make any inquiries designed to determine whether the recommended security was suitable to the needs or financial condition of that customer.

The district court's findings that First Jersey's training and compliance methods were not bona fide attempts to comply with the securities laws were a permissible view of the evidence, and hence are not clearly erroneous, *see Anderson* v. *Bessemer City*, 470 U.S. 564, 574 (1985) ("Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous."). Given these findings, together with the findings as to Brennan's hands-on management and his role in orchestrating the Firm's unlawful acts, the court properly concluded that Brennan failed to carry his burden of showing a good faith effort to discharge his responsibilities.

IV. REMEDIES

Defendants challenge all aspects of the relief ordered by the district court. They contend principally that the injunction and order of disgorgement were improper because the SEC failed to prove that such relief is necessary to prevent future violations; in addition, Brennan contends that he should not be held liable for the full amount of the disgorgement ordered. Defendants also contend that the award of prejudgment interest was unjustified and that the

appointment of a Special Agent was impermissible. We find merit only in the challenge to the appointment of the Special Agent.

A. Disgorgement

Once the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remedies, including ordering that culpable defendants disgorge their profits. *See, e.g., SEC* v. *Lorin*, 76 F.3d 458, 461-62 (2d Cir. 1996) (per curiam); *SEC* v. *Patel*, 61 F.3d 137, 139 (2d Cir. 1995); *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1972). The primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws. *See, e.g., SEC* v. *Wang*, 944 F.2d 80, 85 (2d Cir. 1991); *SEC* v. *Commonwealth Chemical Securities, Inc.*, 574 F.2d 90, 102 (2d Cir. 1978). "The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable. The deterrent effect of an SEC enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits." *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d at 1104; *see SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971) ("It would severely defeat the purposes of the Act if a violator of Rule 10b-5 were allowed to retain the profits from his violation.").

The district court has broad discretion not only in determining whether or not to order disgorgement but also in calculating the amount to be disgorged. *See, e.g., SEC* v. *Lorin*, 76 F.3d at 462. The amount of disgorgement ordered "need only be a reasonable approximation of profits causally connected to the violation," *SEC* v. *Patel*, 61 F.3d at 139 (internal quotation marks omitted); "any risk of uncertainty [in calculating disgorgement] should fall on the wrongdoer whose illegal conduct created that uncertainty," *id.* at 140 (internal quotation marks omitted). We review the district court's order of disgorgement for abuse of discretion. *See, e.g., SEC* v. *Posner*, 16 F.3d 520, 522 (2d Cir. 1994), *cert. denied*, 115 S. Ct. 724 (1995).

Defendants, relying on *United States* v. *Carson*, 52 F.3d 1173 (2d Cir. 1995), *cert. denied*, 116 S. Ct. 934 (1996), argue

that disgorgement was not proper here because the SEC did not show that that relief was necessary to prevent future violations. Even assuming the validity of defendants' premise, their reliance on *Carson* is misplaced. *Carson* was a case brought under the Racketeer Influenced and Corrupt Organizations Statute ("RICO"), 18 U.S.C. § 1961 *et seq.* (1994), which states that "[t]he district courts ... shall have jurisdiction" to impose civil penalties such as divestiture in order "to prevent and restrain violations of [RICO]," *id.* § 1964(a). In light of that language and the "forward looking" examples given in that jurisdictional section, we held that a divestiture order under RICO must be designed to prevent future conduct rather than to remedy past wrongdoing. *See* 52 F.3d at 1181-82. The analysis in *Carson* is inapposite here, since the primary purpose of disgorgement as a remedy for federal securities laws violation is deterrence, through prevention of unjust enrichment on the part of the violator.

Defendants also contend that disgorgement is not needed to reimburse defrauded customers because defendants settled a class action, without objection by the SEC, brought by and on behalf of those customers. This argument too is wide of the mark. Since disgorgement is a method of forcing a defendant to give up the amount by which he was unjustly enriched, it is unlike an award of damages, *see, e.g., SEC* v. *Commonwealth Chemical Securities, Inc.*, 574 F.2d at 102, and is neither foreclosed nor confined by an amount for which injured parties were willing to settle. A settlement payment may properly, however, be taken into account by the court in calculating the amount to be disgorged, and the district court did so here. It acknowledged the $5 million that defendants paid in settlement of the class action but found that the unlawful profits gained by defendants in the six securities at issue here exceeded $27 million. It was well within the court's discretion to give defendants credit for the $5 million paid out to reimburse victims of their frauds and to require defendants to disgorge the rest of those profits. We also conclude that the amount of disgorgement ordered is a reasonable approximation of First Jersey's unlawful profits from its fraudulent transactions and is not punitive in nature.

Brennan contends that the district court erred in making him jointly and severally liable for disgorgement of the total amount of First Jersey's profits and should not have ordered him to disgorge more than the profits he personally received from the transactions in question. We conclude that that order too was within the court's discretion. As discussed in the previous sections, Brennan is primarily liable for the frauds at issue here, having been "intimately involved" in their perpetration, and is also liable as a controlling person of First Jersey. Under the express terms of § 20(a), a controlling person who has failed to establish his good-faith defense is to be held "liable jointly and severally with and to the same extent as" the controlled person. 15 U.S.C. § 78(t). Accordingly, where a firm has received gains through its unlawful conduct, where its owner and chief executive officer has collaborated in that conduct and has profited from the violations, and where the trial court has, within the proper bounds of discretion, determined that an order of disgorgement of those gains is appropriate, it is within the discretion of the court to determine that the owner-officer too should be subject, on a joint and several basis, to the disgorgement order. *See, e.g., Hateley* v. *SEC*, 8 F.3d 653, 656 (9th Cir. 1993) (affirming disgorgement order imposed jointly and severally against broker-dealer securities firm, its president, and its executive vice-president for violations of NASD rules where defendants "acted collectively in violating the association's rules and because of the close relationship among the three of them"); *see also SEC* v. *Hughes Capital Corp.*, 917 F. Supp. 1080, 1088 (D.N.J. 1996) (finding joint and several liability of corporation and individual defendants because all were "knowing participants who acted closely and collectively").

Brennan's contention that he should be required to disgorge only amounts that he withdrew from the Firm might be more persuasive if he had owned less than all of First Jersey's stock. But he was the Firm's sole owner; not surprisingly, he testified at trial that he could request a check in any amount at any time and the Firm would issue one to him. As he owned 100% of the Firm, to the extent that the Firm's net worth was increased by its unlawful activities, so was Brennan's personal wealth.

No more than the total amount of First Jersey's unlawful profits, plus interest on those amounts, is to be disgorged. We see no abuse of discretion in making Brennan individually liable for those sums, jointly and severally with the company he owns. Accordingly, we decline to overturn the order for joint and several disgorgement.

B. Prejudgment Interest

The district court ordered defendants to pay prejudgment interest totaling $52,689,894. Defendants argue that this amount is grossly disproportionate to the amount of disgorgement ($22,288,099) and was unduly inflated because the court (a) improperly used the rate employed by the Internal Revenue Service ("IRS") for an underpayment of taxes, rather than the treasury-bill rate (resulting in a difference of more than $23 million), and (b) inappropriately ordered that interest be paid for the entire 12-year period since the violations occurred notwithstanding delays that defendants attribute to the SEC. We see no abuse of discretion in the court's prejudgment interest award.

"The decision whether to grant prejudgment interest and the rate used if such interest is granted are matters confided to the district court's broad discretion, and will not be overturned on appeal absent an abuse of that discretion." *Endico Potatoes, Inc.* v. *CIT Group/Factoring, Inc.*, 67 F.3d 1063, 1071-72 (2d Cir. 1995) (internal quotation marks omitted). In deciding whether an award of prejudgment interest is warranted, a court should consider "(i) the need to fully compensate the wronged party for actual damages suffered, (ii) considerations of fairness and the relative equities of the award, (iii) the remedial purpose of the statute involved, and/or (iv) such other general principles as are deemed relevant by the court." *Wickham Contracting Co.* v. *Local Union No. 3*, 955 F.2d 831, 833-34 (2d Cir.), *cert. denied*, 506 U.S. 946 (1992); *see also Commercial Union Assurance Co.* v. *Milken*, 17 F.3d 608, 613 (2d Cir.), *cert. denied*, 115 S. Ct. 198 (1994). In an enforcement action brought by a regulatory agency, the remedial purpose of the statute takes on special importance.

When the SEC itself orders disgorgement, *see* 15 U.S.C. § 78u-2(e) (1994), which as discussed above is designed to strip a

wrongdoer of its unlawful gains, the interest rate it imposes is generally the IRS underpayment rate, *see, e.g.*, SEC Rules & Regulations, 60 Fed. Reg. 32738, 32788 (June 23, 1995). That rate reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from its fraud. Accordingly, courts have approved the use of the IRS underpayment rate in connection with disgorgement. *See SEC* v. *Drexel Burnham Lambert, Inc.*, 837 F. Supp. 587, 612 n.8 (S.D.N.Y. 1993) (citing cases), *aff'd*, 16 F.3d 520 (2d Cir. 1994), *cert. denied*, 115 S. Ct. 724 (1995).

Though defendants urge that the treasury-bill rate of interest should have been used instead, that is the rate at which one lends money to the government rather than borrows money from it. That advantageous rate would seem highly inappropriate in the circumstances here, where defendants have had the use of the money.

Nor are we persuaded that it was inappropriate to order that prejudgment interest be paid for the entire period from the time of defendants' unlawful gains to the entry of judgment. Even if defendants were correct that the present litigation was protracted through some fault of the SEC, defendants plainly had the use of their unlawful profits for the entire period, except for $5 million paid to settle the class action, on which, as discussed above, the court did not include interest for the period subsequent to payment. Given the remedial purpose of the statute, the goal of depriving culpable defendants of their unlawful gains, and the lack of any unfairness to defendants, we see no abuse of discretion in the court's order.

C. The Permanent Injunction

We also reject as meritless defendants' contention that the district court erred in permanently enjoining them from future violations of § 17(a), § 10(b), and Rule 10b-5. An injunction prohibiting a party from violating statutory provisions is appropriate where "there is a likelihood that, unless enjoined, the violations will continue." *Commodity Futures Trading Commission* v. *American Board of Trade, Inc.*, 803 F.2d 1242, 1250-51 (2d Cir. 1986); *see also SEC* v. *Posner*, 16 F.3d at 521-22. Such an

injunction is particularly within the court's discretion where a violation was "founded on systematic wrongdoing, rather than an isolated occurrence," *United States* v. *Carson*, 52 F.3d at 1184 (internal quotation marks omitted), and where the court views the defendant's degree of culpability and continued protestations of innocence as indications that injunctive relief is warranted, since "persistent refusals to admit any wrongdoing ma[k]e it rather dubious that [the offenders] are likely to avoid such violations of the securities laws in the future in the absence of an injunction." *SEC* v. *Lorin*, 76 F.3d at 461 (internal quotation marks omitted); *see also SEC* v. *Posner*, 16 F.3d at 521 (where defendants violated securities laws with "high degree of scienter" and failed to assure court that future violations were not likely to recur, injunction was warranted).

In determining that a permanent injunction was warranted in the present case, the district court noted that First Jersey continued to be a broker-dealer owned by Brennan and that it employed a number of key personnel who worked at First Jersey between 1982 and 1985. Brennan himself has remained an active participant in the securities markets. *See, e.g.*, *Hibbard, Brown & Co.*, 58 S.E.C. Docket 2561, 1995 WL 116488, at *1 (Mar. 13, 1995) (describing Brennan's purchase in 1991 of 1,450,000 units of securities). The district court also noted that First Jersey and Brennan had a history of engaging in activities that led to misconduct charges, followed by sanctions imposed by various regulatory agencies or courts, followed by new misconduct charges. Thus, the record showed, *inter alia*, that for a month in 1973, Brennan was suspended from the sale of mutual funds by the New Jersey Bureau of Securities. In 1974, Anthony Nadino, Brennan's brother-in-law and First Jersey's head trader at all times relevant to this case, was federally enjoined from further violations of the antifraud provisions of the securities laws based on his promulgation of false and misleading quotations and manipulation of the market while employed at another broker-dealer prior to coming to First Jersey. *See SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801, 810-11, 814 (2d Cir. 1975). In 1984, in settlement of the SEC's 1979 Proceeding and its Geosearch action, defendants were enjoined against engaging in certain transactions with regard to securities underwritten by First Jersey and a special consultant

was appointed to monitor the Firm's practices. In 1986, NASD commenced and settled a proceeding entitled *Market Surveillance Committee* v. *First Jersey Securities, Inc., Robert E. Brennan, and Anthony Nadino*, Complaint No. MS-261 (Feb. 7, 1986), concerning markups in Trans Net warrants; First Jersey, Nadino, and Brennan were censured, First Jersey was fined $300,000, and Nadino and Brennan were fined $25,000 each and suspended for 10 days from association with any NASD member. In 1990, NASD commenced and settled a proceeding entitled *District Business Conduct Committee* v. *First Jersey Securities, Inc., Robert E. Brennan, John E. Dell, Frederick A. Eyerman, et al.*, Complaint No. NEW-619 (Sept. 24, 1990), concerning violations of the NASD's Rules of Fair Practice, in which First Jersey was fined $50,000 and Brennan *et al.* were censured.

The district court also observed that Brennan, whose trial testimony the court characterized as "belligerent[ly] evasive[ ]," 890 F. Supp. at 1207, took the position in the present case that defendants had done nothing wrong and that if there had been any violations they were merely accidental. In light of defendants' disciplinary record, their deliberate and systematic frauds in the present case, and their continued protestations of innocence, it was well within the discretion of the district court to conclude that permanent injunctive relief is warranted.

D. The Appointment of a Special Agent

Finally, defendants challenge that part of the judgment which provided for the appointment of a Special Agent to determine whether, during the period between 1982 and 1987, First Jersey engaged in fraudulent activity beyond that proved at trial. The district court, in its opinion, stated that it was convinced that the violations pleaded and proven with respect to the six securities at issue in the present litigation were but "the tip of the iceberg." 890 F. Supp. at 1212. Citing its general equity powers, the court stated that a Special Agent would therefore be appointed to investigate the possibility that, in 1982-1987, First Jersey had committed additional violations of the securities laws that the SEC had not pleaded or proven. The Special Agent would be directed, in the event that he found excessive markups or markdowns, to "recommend to the Court that defendants disgorge and pay over,

as the Court may direct, all illegally-obtained profits." 890 F. Supp. at 1213. The final judgment stated that the Special Agent would be appointed thereafter, with his powers and duties delineated in a subsequent order. We find merit in defendants' challenge to this part of the judgment.

> Section 21(a) of the 1934 Act gives the SEC authority to
>
> make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of [the securities laws], the rules and regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member....

15 U.S.C. § 78u(a)(1). The Commission is given limited authority to delegate these investigatory powers; § 4(b) allows it to "appoint ... such officers, attorneys, examiners, and other experts as may be necessary for carrying out its functions under [the securities laws]." *Id.* § 78d(b)(1). This authority, which needed no court order for its exercise, provides no basis for the appointment of the Special Agent envisioned by the judgment in this case, for the agent was not to be one appointed by the SEC, but one appointed by the court.

The court itself, of course, has authority to make appointments of special personnel to assist in the court's judicial functions, such as special masters to assist in the adjudication of complicated factual issues, *see* Fed. R. Civ. P. 53, or trustees to oversee compliance with the court's final judgment, *see, e.g., SEC* v. *S & P National Corp.*, 360 F.2d 741, 750 (2d Cir. 1966). The appointment of a Special Agent in this case, however, is not for the purpose of assisting in adjudication of a case before the court. Though the SEC argues that appointment of the Special Agent is appropriate because his appointment "is merely a mechanism to assist the court in ascertaining the appropriate amount of disgorgement" (SEC brief on appeal at 49), this argument disregards the fact that the claims brought by the SEC in this case have now been adjudicated, and the appropriate amount of disgorgement to deprive defendants of the unlawful gains from the transactions pleaded and proven in this litigation has been

determined. Disgorgement is permissible relief for a valid claim of violation of the securities laws; but disgorgement is not a claim in itself. *See generally Franklin* v. *Gwinnett County Public Schools*, 503 U.S. 60, 69 (1992) (The "'question whether a litigant has a "cause of action" is analytically distinct [from] and prior to the question of what relief, if any, a litigant may be entitled to receive.'" (quoting *Davis* v. *Passman*, 442 U.S. 228, 239 (1979)). We do not regard the appointment of an investigator, whose instructions are to unearth claims not previously pursued by the SEC, as ancillary to the adjudication that has been completed.

Nor is the appointment in this case for the purpose of ensuring compliance with the court's judgment. The Special Agent's role, as described by the district court, is not to ensure that defendants comply with the terms of the permanent injunction in the future. Rather, his role is purely retrospective and investigative. While the court indisputably has some inherent power to make appointments ancillary to its judicial function, we cannot conclude that the investigation of past acts with a view to the recommendation of new charges is a judicial function. Nor can we have confidence that the appointment of an agent to pursue such an investigation would, with respect to any recommended charges resulting from the investigation, preserve for the court the appearance of impartiality.

The parties to an action may themselves agree, of course, subject to court approval, that a special officer is to be appointed to make such investigations. *See, e.g., Handler* v. *SEC*, 610 F.2d 656, 659-60 (9th Cir. 1979). But we are not aware of any case, other than one in which a judgment has been entered on consent, in which an investigative agent has been appointed by the court for the purpose of unearthing past wrongs in addition to those encompassed by the pleadings and proven at trial and recommending new charges to the court. *See id.* at 659 (emphasizing that "the district court did not impose special counsel upon" the corporation).

In sum, though "if a right of action exists to enforce a federal right and Congress is silent on the question of remedies, a federal court may order any appropriate relief," *Franklin* v. *Gwinnett County Public Schools*, 503 U.S. at 69, we do not regard

the appointment of an investigator to determine whether or not the plaintiff had an additional right of action as either appropriate relief for the rights asserted or a proper exercise of the judicial function. Accordingly, we reverse so much of the court's judgment as appointed the Special Agent.

CONCLUSION

We have considered all of defendants' contentions on this appeal and, except to the extent indicated above, have found them to be without merit. So much of the judgment as appointed a Special Agent is reversed. In all other respects, the judgment of the district court is affirmed.

Costs to plaintiff.

United States District Court
Southern District of New York

SECURITIES AND EXCHANGE COMMISSION,
Plaintiffs,

v.

FIRST JERSEY SECURITIES, INC.,
and ROBERT E. BRENNAN,
Defendants.

OPINION AND ORDER
85 Civ. 8585 (RO)

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OWEN, District Judge.

This civil action instituted by the Securities and Exchange Commission in 1985 was tried before me without a jury over some forty days in 1994. The amended complaint alleges that defendant First Jersey Securities, Inc., owned, operated and controlled by defendant Robert E. Brennan, realized illegal profits from excessive markups on sales from its inventory to its customers of the securities of three companies, Sovereign Chemical and Petroleum Products, Inc., Rampart, Inc. and Quasar Microsystems, Inc. in the years 1982-83. The amended complaint seeks a permanent injunction against certain future violations of the securities laws and disgorgement of all profits, from such sales together with prejudgment interest thereon, and the appointment of a special agent of the Court to examine all of First Jersey Securities' records from November 1982 to the present to determine the existence, if any, of similar violations and empowering such agent to recommend further proceedings and appropriate disgorgement if required.

Further, starting with an exploratory order in November 1987, I thereafter permitted similar issues to be raised and tried as to First Jersey's transactions in three other securities, Transnet Corporation in 1983, Sequential Information, Inc. in 1984, and QT&T, Inc. in 1985 (formerly Quasar Microsystems, one of the issuers named in the amended complaint),[1] and with the same request for disgorgement of profits should the facts warrant.

First Jersey, a broker-dealer registered with the Securities and Exchange Commission, commenced business in 1974[2] and by the early 1980s was operating as many as 36 retail branch offices nation-wide from its main offices in New York, New York and Red Bank, New Jersey. At its high point, First Jersey had approximately 1,200 salesmen or "registered representatives" and a retail customer base of more than 500,000 accounts. The foregoing retail selling capabilities enabled First Jersey to gross as much as 95 million dollars a year, 80 to 90 percent of which came from transactions in which it was selling as a principal and income from underwriting. The securities in which First Jersey dealt were generally priced at three dollars or less and were traded in the over-the-counter market.[3] Most of First Jersey's organization including research, compliance, operations, administrative and

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[1] The SEC at the outset contended that such proof, should it be established, would be evidence of defendants' continuing wrongful intent.

[2] First Jersey filed a form instrument with the SEC on February 22, 1995, after the closing arguments before me in this case entitled "Uniform Request for Withdrawal from Broker-Dealer Registration," containing the statement that it ceased business "Effective January 10, 1995."

[3] The over-the-counter market is a market essentially of telephone lines among many, many broker/dealers. Any registered broker/dealer can enter the over-the-counter market, and its "market place" consists of phone calls between brokers. This is in contrast to the New York Stock Exchange and the American Stock Exchange, which are centralized markets, where substantially all the orders both to buy and sell come into one marketplace.

Another difference is the information available to investors and potential investors in the respective marketplaces. At the time of the securities here at issue—the early 1980's—the over-the-counter market involved no real time reporting of what the volume or the price of over-the-counter securities transactions were.

trading operated in New York City. Customers' statements, checks and securities were mailed from its main office in New York City. Branch offices did not perform operating functions. All mark-ups on First Jersey sales of securities were calculated in the trading department in First Jersey's New York office. First Jersey sought as salesmen in its branch offices individuals who had no prior experience in the securities field[4/] for reasons that become obvious hereafter, given its methods of operation. One salesman, curious as to this, testified as to the result of his inquiry:

> Not one guy that I worked with had ever been with a brokerage firm ever. . . . [the branch manager] always made the comment that he would not hire a broker who had been with an existing brokerage firm, . . . because they develop bad habits, work habits and that they just wouldn't hire them.

While First Jersey held itself out as being a full-service broker-dealer, its operations apart from underwriting and transactions into and out of inventory were very limited, the vast majority of its salesmen's efforts being to sell, under the direction of its branch managers, securities which First Jersey held in inventory as principal. This operation was typically on a monthly cycle and was quite rigidly controlled and supervised in whatever branch offices were selected to be involved in a given marketing situation. As is described *infra*, at times, basically certain branches would sell an underwriting to customers and then buy it back, and other branches would then sell the components from the repurchased instruments to *their* customers who were necessarily different from and ignorant of the customers involved in the underwriting and repurchase.

The duties of each of the 1200 salesmen were substantially the same, regardless of the location of the branch office. This was representatively described by a salesman formerly in the Houston, Texas office.

4/ Not atypical were such as a waiter in a restaurant, a bellman in a Playboy Club, and an employee of a 7-11 convenience store.

Q. Now, when you went to work for First Jersey, what if any, orientation were you provided?

A. Very little, if any. I just—it was a condition, first of all, it was just to pass my NASD Series 63 and just learn a script. That was it.

Q. What is the script that you're referring to?

A. Well, just prospecting. Once you get licensed, then you just get on the phone and you start prospecting. And the script [from the branch manager], it was just a couple of paragraphs. You just get on the phone and just would say, hello, Mr. Jones, my name is John Nooney. I'm with First Jersey Securities. How are you today?

And I would just go, Mr. Jones, First Jersey Securities, we're full service investment brokers. And as such, we handle all buy-sell orders on the listed exchanges or the over-the-counter market. We also get involved with tax reinvestments, tax shelters, IRA's. But where we specialize in and where we're best on Wall Street is our timely recommendations of stocks usually trading between two, ten dollars, in that price range.

I'm not calling you with anything specific at this time. And I was just simply wondering if something exciting did present itself on the market, would you appreciate a call.

It's been a while since I've done that, but I did that for two years straight.

Q. Where do these scripts come from?

A. Well, from Tom. The office managers. They just provided it.

Virtually all of the twelve former First Jersey salesman who testified for the SEC described the "script". Representative is such testimony as that of Frederick E. Thyer from the Atlanta office:

> [We] did have a script that we used and this was given to us by [the manager].

Donald E. Strong from the Shawnee Mission, Missouri office stated:

> [The manager], would give us a presentation as to how we would present this particular opportunity to our clients.

Claude Ware of the New Orleans office testified:

> Q. Was there a typical monthly pattern?
>
> A. Yes, there was. . . . For the first three weeks we went through the phone book and, you know, called people to find out who would be interested, which we would call them our prospects. And then usually the Monday, Tuesday of the fourth week before our month ended we would go and sit down with people that would sit down with us. And then the last three days, usually Wednesday, Thursday and Friday, we would start selling. That's when [the manager] would come out and give us the stock, and we would sell the last three days of the month.
>
> Q. How about research, was there any research being done at the New Orleans office while you were there?
>
> A. No.
>
> Q. And did you do any research while you were there?
>
> A. No.
>
> Q. Why was that?
>
> A. Basically there was no access. You couldn't find the stocks they were recommending, so where could you go? [The manager] gave us a presentation to go by, and that's basically all we ever used.

Q. Now, what kind of information was actually provided to you about the recommended stocks?

A. It was everyone was basically the same. It was about a page and a half of a legal pad, maybe a page presentation. And they all started the same way. I mean, he gave us, you know, spectacular turnaround situation, was a line that was almost in every presentation.

Or Jeffrey Ingles of the Houston office:

Q. So that what you called a script which came out of the sales recommendation meeting was nothing more than the notes that you took at the meeting, correct?

A. No, it was a verbatim presentation.

Q. Why do you say that?

A. Because it was repeated several times until we had it correct in our notes.

Q. And you were expected to take down every word?

A. That's correct.

Q. Who told you that?

A. [The manager].

Robert Holly of the Red Bank, New Jersey office stated:

We did have scripts which were handwritten in our own, and it was presented to us at a meeting with the, in meetings the information was presented to us in such a way that the branch manager, whether it was Egan, Dell or Hart, said, this is the way I would recommend, this is the way I would present this investment, and it was in our

> own handwriting, if that is a script. * * * I wrote down verbatim and adjusted it as to my liking.[2]

Or Gerard Doyle of the San Diego, California office:

> [The manager] would come out of his office; he would tell us to clear the phones . . . for the purpose of duplicating the script. I'm sure if you can memorize it, that would be fine, but in most cases everybody had to write the script down.

The process used by the salesmen goes by the description "cold-calling," and a registered representative in another First Jersey office apparently needed some coaching before going to work. He testified:

> Q. Could you describe what [the manager] said to you and what, if any, instructions he gave you the first time you met him after passing the Series 63 Exam?
>
> A. He told me to keep studying the information they had given me in the packet, primarily at that point the prospecting script, and he had me say the script to him once while I was there and he said it still needed a little work and to make sure that I had studied it more before our next meeting.

Little attention, if any, was given to instruction in terms of customary brokerage procedures or operations. One salesman's testimony was fairly representative:

> Q. When you began working at First Jersey, were you provided with any manuals or handbooks or policy directives material of that sort?
>
> A. No.

* * *

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[2] Interestingly, Mr. Holly was a witness whose deposition was scheduled by the defendants.

> Q. [W]hat, if any, directions . . . were [you] given about how to go about your work as a registered rep.
>
> A. Well, again, as far as the direction, it was just to prospect. That was the primary and the only direction is to get people that would listen to your story.
>
> Q. And what did prospecting involve?
>
> A. Well, it involved just getting names of people. Corporate directories were very big. Chamber of Commerce. Any lists. . . . And you would just call up and just get on the phone. And just like I mentioned before, I just had that one script in front of me and that's all I had to do.

A Houston salesman testified:

> The day I passed my test, [the branch manager] took me to the back room . . . where all the brokers worked, and said, this is your desk. And he grabbed a phone book and he opened it up on my desk and opened it to the electricians and pointed E, he said, those are great guys to call. And he handed me a script to read to get, to qualify the guys.

The timing of these activities was coordinated by branch office managers. The process of recontacting prospects was known as variously "touching base" or "requalifying". Branch office managers received instructions on when to requalify and when to recommend securities from First Jersey's main office in New York. Generally, under the direction of their office managers, branch office salesmen performed the task of prospecting, requalifying and recommending securities to their customers as a group. If a prospect agreed to consider a future recommendation, salesmen were instructed to record his or her name, address and other identifying information. Salesmen were to make only a general inquiry as to whether the customer was willing to accept "risk". Until this action was filed in October 1985, First Jersey did not

require salesmen to record a customer's income or investment objectives in any record.

During each monthly cycle which coincided with the pay period, after "prospecting", First Jersey branch office managers would inform their salesmen that First Jersey's research department would recommend an investment in the near future. The salesmen were then to recontact prospects to determine how much money they had available to invest. This was called "qualifying".

At that time, however, salesmen were not told the name of the company whose securities would be recommended and had no specific information regarding the upcoming recommendation. One salesman described the qualifying conversation as follows:

> [Y]ou call up and you say, hello, Mr. Jones, John Nooney at First Jersey Securities. How you doing? Did you get my card? Usually, you always sent out your card after you talk to them initially. Okay, good. Well, I just wanted to let you know that I've been in touch with research, and we're going to be looking at something super. And it's probably going to be developing in the next week or two. Are you in a position where, if it looks good for my clients, should I keep you in mind?
>
> That was it. And again, you're looking for the interest and ability. And the fellow would go, yeah, John, keep me in mind. Okay. Well, we'll probably be taking positions, maybe a couple thousand shares. Are you in a position to take advantage of it?
>
> Then you just find out whether or not then he has the ability. And if he does, great. Then you just move him from this little pile to this pile. If he doesn't, zip, and you throw him away. And you just go on right to the next one.

The "qualifying" process had nothing to do with a particular customer's needs or situation, but rather was a method

for determining how much total customer money was available for an upcoming First Jersey recommendation.[6/] Following this, First Jersey from its New York City or Red Bank, New Jersey offices informed branch managers of the security to be recommended that month to its retail customers, whereupon, during the last week of a pay period,[7/] branch managers held "recommendation meetings", for all their salesmen. The managers dictated a sales presentation or "script" on how to sell the recommended security. Salesmen were required to record these presentations and use them in contacting clients. One salesman's testimony was fairly representative:

> The selling presentation began with [the branch manager] coming out of his office. And everybody knew that was the day that we were going to . . . sell the stock of the month, because that's—all of our commission that month came the last three days. Sometimes it started on a Monday, which was the whole last week, just depending on when [the branch manager] got the stock, I assume.
>
> And he would come out of the office and everybody would, had their legal pads, and he would give us a presentation of the stock.
>
> Q. What would he say?

[6/] One salesman testified:

> [We were trying] to find out really as much as you can, what other stocks that he owned, and just try to get a feel for the guy as far as really how wealthy he really was.

[7/] The timing of this was psychologically well-conceived, creating not only the goad to an individual salesman's incentive to maximize earnings before the cut-off, but also the peer pressure and team effort of all the salesmen collectively selling in each other's sight and hearing in the one big salesroom which each branch office had. I note that a further incentive to the salesmen here was the 10% commission on these transactions as contrasted to 3% on agency or non-First Jersey-recommendation transactions.

A. It was, Mr. Jones, . . . I have a spectacular turnaround situation. He verbatim gave us a presentation to write down, word for word[.] And then at the end he would always say that now the best part, and the commission is ten cents a share, whatever it was at that point. And then he would say, okay, hit it. And then he would walk out of the room and we'd begin selling, we'd get on the phone, everybody at once, and start selling.

Q. How many stocks were there that were characteristically recommended at these kind of meetings?

A. It's just one.

As to research information, another salesman testified:

The only time we were provided with any information would be just on a recommendation. That would be the previous year's annual report, if they had one, or just if they were manufacturing a product, just their sales brochure. And we would get that at the meeting. Everybody would be together. And the direction was to try to pick out ten closes out of the material that we have . . . that you could use to sell the stock to your clients and prospects.

Q. What is a close?

A. Hello, Joe, listen, we should take a thousand shares of this. The opportunities of tomorrow aren't going to stare you in the face today. You know, this thing looks super. We feel it's going to go. Get as much of this as you can. And you'd hammer them. You'd stay on the phone until—if they didn't buy, because you're not going to get another shot. And you would just stay on the phone. You were praised, really, for—I always remember this one guy, I mean, I just

> stayed on the phone for almost an hour, and he finally bought.

Salesmen were also advised of the commission they would make on the sale of a new recommendation at the recommendation meeting. Commissions for First Jersey recommendations ranged from three percent for underwritings to as high as ten percent for principal transactions. In addition, First Jersey office managers received a 50% "override commission" on all sales,[1/] which at times were split with other senior salesmen. After a branch office recommendation meeting, all salesmen in the office were expected to sell the recommended security to their customers, and they all recommended the same security at the same time at the end of a pay period. Negative factors, such as risks inherent in the recommended security, were generally not discussed. Deviation could incur wrath, as one salesman recalled it:

> Q. Now, over ... the two years or so that you worked at First Jersey, do you have a sense of how your clients made out on recommended purchases that you recommended to them?
>
> A. [M]y clients lost considerable bit of money.
>
> Q. Did any of them make money over that period?
>
> A. There were times in which stocks we had recommended were up in value, but those were unrealized gains; we never sold them and let the client keep the money. They were always rolled over, so to speak, into a new recommendation.[2/] We were not allowed by ourselves to sell a stock out unilaterally without the other brokers doing it. There was always a recommendation to do it

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1/ A number of First Jersey managers had incomes in the many hundreds of thousands of dollars a year.

2/ See the Sovereign-Rampart transactions described *infra*.

jointly. My clients did not make money in that process.

Q. Was there ever an occasion when you recommended to your client that they sell out and realize these unrealized profits?

A. It happened to me, yes. I had an initial public offering, a company called MEDIVIX. The stock was up, this is the best of my recollection, 50 to 60 percent. If you came in at a dollar a share, it was to $1.60. I had a client who had that. I recommended to him to sell it. He was losing on all his other stocks. I just wanted to show him here's a profit. I recommended it—one of the few times I took the initiative on my own—another stock that I liked that was a previous First Jersey recommendation. I placed him into it on my own.

Q. What was the reaction of the management to that activity?

A. Within a hour I was called into a meeting [with the manager,] * * * I was told that I had done the wrong thing. I was told that Jack Dell[10/] was very displeased with what I had done, and who gave me the authority to go ahead and sell stocks when the home company had not made a recommendation. These were carefully researched companies. We were to buy when we were told to and sell when we were told to sell. I was reminded of that.

The salesmen were instructed to be aggressive with customers to get them to "roll over" their money as described above. One testified:

A. If a client was involved in an underwriting and did not follow the recommendation to take profits and move those profits into the second

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10/ Dell was First Jersey's Director of Sales.

> recommendation, then we were told not to recontact them with underwritings. [This was done] . . . [i]n a meeting format with all the brokers and [the managers] in front of us, because it did happen on occasion where somebody would just take the money and try to run.
>
> Q. What happened on those occasions, if you recall?
>
> A. We were told to get back on the phone, recontact the client, and try to get them to continue to invest all the monies with us.

A typical format to induce such a roll over was as follows:

> THE WITNESS: A meeting was held to take profits in TransNet and presentation given to take those proceeds and move into Lincoln Log warrants.
>
> THE COURT: How do you take the profits? Tell me what happens.
>
> THE WITNESS: You tell the client that [you] bought the units at $1 a unit, they are now trading in the aftermarket at a dollar and a quarter, we think we have a nice profit in there, and we have another situation we think we can also make some profits in, let's lock in [your] profits on TransNet and move it into the next company.

First Jersey salesmen were given directions not to discuss branch office recommendations with salesmen from other First Jersey branch offices, because some branches were buying back common stock or units of a company at much lower cost than other branches which were at the same approximate time selling the same common or components from the units to other customers at inflated markups. Salesmen were also discouraged from conducting independent research on First Jersey recommended securities, and requests to the New York City office for information concerning

such securities had to be channeled through the branch manager, for control.[11/]

The proof at trial[12/] established that as to the six instances between late 1982 and early 1985, as to which the SEC offered proof, First Jersey repurchased from certain of its retail customers securities that it had previously underwritten and immediately resold those securities (or, in most instances, components thereof) at illegal markups, to *other* retail customers for a total profit to First Jersey on those sales of more than $27 million, without disclosure to either group of customers.[13/]

[11/] I credit the foregoing testimony of those former First Jersey salesmen who testified live or by deposition before me notwithstanding Brennan's threat to them, *see infra*, and I reject any testimony of First Jersey's former branch managers to the contrary. Most of these managers went first to Sherwood Capital to which First Jersey sold all but three of its branches, those three going to F.N. Wolf, and even today after Sherwood shortly passed from the scene went on to such firms as Hibbard Brown or F.N. Wolf with which Brennan has substantial continuing connections, *see infra*. There, continuing relationships have kept them directly or indirectly in Brennan's thrall. And, of course, the mountainous statistical evidence from First Jersey's transactional and commission records supports the credibility of the former salesmen's testimony beyond peradventure.

[12/] At the core of this proof was a massive statistical work-up by SEC staff accountant Robert Lowry of all of First Jersey's transactions in the securities in issue taken from First Jersey's records. This was then assessed against contemporaneous law by plaintiff's expert, Professor Robert Haft.

[13/] As to Rampart, the same basic format was used, except that instead of repurchasing *units* from customers to whom it had just sold such units, First Jersey repurchased over 2,000,000 shares of common stock at $1.50 from customers it could locate from its records to whom it had previously sold such stock, and then resold approximately the same amount to other customers at $2.50.

(continued...)

In most of the instances, the programmed format began with First Jersey as an underwriter selling "units" to the public in a small unknown company. First Jersey in each case was the sole underwriter and set it up this way with each issuing company.[14] Each unit generally consisted of a number of shares of stock and one or more warrants. The prospectuses under which these units were sold all provided that the units were to remain intact (that is, the components could not be "unbundled" and sold separately) for some period of time such as six months, "or such earlier date as may be elected by the underwriter"—that is, First Jersey.

Thus, taking Sovereign as a representative example, First Jersey had been authorized to sell commencing November 9, 1982, 1,100,000 Sovereign units in an underwriting. Each unit consisted of 3 shares of common stock and 1 warrant. The units were not to be split for six months (except at First Jersey's option). The underwriting price was $3 a unit and on the first day of the underwriting, First Jersey sold almost 1,700,000 units, obviously over-selling by some 600,000 units. Then, within days, First Jersey bought back over 1,300,000 units at $3.50,[15] and immediately split the units

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[13] (...continued)

The Branches Listed Below Accounted for 83% of the Rampart Repurchases from Customers	The Branches Listed Below Accounted for 96% of the Rampart Sales to Other Customers
Denver, Mass.	Falls Church, Va.
Houston, Texas	Atlanta, Ga.
Wayne, Pa.	New Orleans, La.
Rochester, N.Y.	Red Bank, N.J.
	N. Palm Beach. Fla.

[14] The issuing companies obviously accepted this structuring of the underwriting by First Jersey, since the issuers' essential interest was to get the funding the underwriting would provide.

[15] First Jersey attempted to attribute this overselling by 600,000 units to problems of recordkeeping and salesmen's exuberance, and the repurchases to covering what (continued...)

into their components, (not having told the customers from whom the units were bought that was their intention). It then priced the components of the units just repurchased for $3.50 at approximately $8.00 ($2.25 to $2.50 for each of the 3 shares of stock and $1 for the warrant) and immediately sold over 3,000,000 shares of common and over 1,200,000 warrants to other customers at other branches, without telling these customers of its immediately prior unit buy-back.

In rounded-off outline, with 1,100,000 units authorized, First Jersey's transactions in Sovereign Chemical commencing November 9, 1982, the first day of the public offering, were as follows:

11/9	FJ Sells	1,689,000	Units at 3
11/18	FJ Repurchases	1,162,000	Units 3½
11/19	FJ Repurchases	159,000	Units 3½
11/22	FJ Repurchases	50,000	Units 3½

The units, each consisting of 3 shares of common stock and 1 warrant, split on 11/22.

11/22	FJ Sells	1,291,000	Common 2¼
11/23-26	FJ Sells	1,809,000	Common 2½
11/24	FJ Sells	1,223,000	Warrants 1

This pattern was followed thereafter in five other issues. In Quasar, the repurchases of the units by First Jersey started the

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[19] (...continued)
it was "short". This claim founders on the fact that First Jersey repurchased some 700,000 shares more than it needed to cover any "short"—paying, I note, a slight premium for all shares—demonstrating that this was part of its plan to build up an inventory, split the units and sell the components at the mark-ups as discussed *infra*. The claim is further undercut by what happened in Sequential. There, First Jersey did *not* oversell the units in the underwriting, selling 2,941,000 units of the 3 million authorized. The next day it bought almost all of it back at a ¼ point markup so as to have inventory of common stock bought at 4½ cents from which to sell at 12½ cents starting five days later. Here I note that, it sold more common stock than were in the units it bought back, indeed, more than were in *all* the units in the underwriting and there was no proof before me that it even bothered to cover its ultimate short sale of the common stock.

same day as the underwriting and First Jersey's sales of the broken-out common started the next day.[16] In Sequential, as earlier observed in a different context, where each unit contained 50 shares of common at 4 cents,[17] not to be split for 3 years except at First Jersey's option, 2,900,000 units were sold on the underwriting on June 13, 1984; 2,300,000 units were bought back the next day, and within the next two weeks, First Jersey sold 153,000,000 shares of common from the units for 12½ cents each, having bought them back in packaged form at 4½ cents each. Here First Jersey did not get around to sending the formal letter to the company to effect the breakout until June 29, *after* the 153 million shares of common had been sold.

It is accordingly overwhelmingly evident that First Jersey in each of these five underwritings intended, prior to the time of the underwriting, to immediately repurchase the units just sold, and make its own decision as to how far up it would mark the components for resale with no concern for any market. It could do this since it *was* the market. Thereafter, using its 1200 programmed salespersons and 500,000 customer accounts spread among more than 30 branch offices, it sold to those selected buyers who were as much in the dark as to prevailing market price as were its other customers who had just sold back to First Jersey in these little-known companies.

Defendants First Jersey's and Brennan's conduct, was entirely purposeful. It was planned this way. This is clear not only from the patterned and repeated format of the trading, but also from the simple programmed structure of First Jersey's marketing system.[18] Defendants orchestrated every facet of First Jersey's branch office network to ensure that the firm's underwritings and

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[16] Here the units were not to be separately transferrable for 90 days, ". . . or such date as [First Jersey] shall determine." On this record, there is no evidence that as to Quasar, First Jersey ever sent the "determin[ing]" letter to the issuer.

[17] $2.00 a unit for 50 shares.

[18] See *supra* where salesman Nooney, in his deposition in 1988, could recite from memory his First Jersey-provided-script he had used for "two years straight" some four to six years before.

other low-priced stock recommendations were sold *when* they wanted—*where* they wanted—at prices determined not by market forces but by First Jersey itself. Its salesmen themselves, with minimal information and the incentive of earning as much as ten percent (plus a five percent managers' override) on a customer's investment dollar, were accordingly able to sell to the firm's customers securities at illegal mark-ups up to as much as 150 percent.

I conclude without question that defendants' conduct with respect to the sales and resales of securities to First Jersey's customers, as described above, violated Section 17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(a) (1993), and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(B) (1993) and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, (detailed *infra*) and constituted a massive and continuing fraud on its customers, founded on the use of fraudulent devices in the offer, purchase, and sale of securities. The whole point of the scheme was to leave both the customers selling securities back to it (usually "units") and the customers purchasing securities from it (usually "unit" components), completely ignorant of the way in which First Jersey had in all other respects dealt in those securities, and as to the sales of the components, First Jersey's salesmen knew almost nothing about the companies, and knew they were selling to buyers who knew even less. Particularly in a factual context where First Jersey dominated and controlled the markets for the respective securities, this is unquestionably securities fraud under decisions that go back over fifty years.

Since 1939 it has been clear that a registered broker-dealer such as First Jersey impliedly represents, by virtue of doing business or "hanging out its shingle", that customers will be dealt with fairly, and that a broker who violates this representation also violates the general antifraud provisions of the securities laws. In *Duker & Duker*, 6 S.E.C. 386 (1939), the Commission, reviewing the actions of a broker-dealer that had induced its customers to exchange securities that they owned for bonds which the broker-dealer sold them at above-market prices, stated that

> [i]nherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession. . . . [F]raud is avoided only by charging a price which bears a reasonable relation to the prevailing price or disclosing such information as will permit the customer to make an informed judgment upon whether or not he will complete the transaction.

Id. at 388-389.

The Commission's administrative orders being subject to review by the federal courts of appeals, *see, e.g.*, 15 U.S.C. § 78y(a) (1993), the principles of *Duker & Duker* were shortly specifically approved by the courts. In *Charles Hughes & Co.* v. *SEC*, 139 F.2d 434 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1944), the Second Circuit affirmed a Commission order revoking a broker-dealer's registration for, among other things, violations of Section 17(a) through "continued sales of securities to customers at prices very substantially over those prevailing in the over-the-counter market, without disclosure of the mark-up to the customers." *Id.* at 435.

> Even considering petitioner as a principal in a simple vendor-purchaser transaction . . . it was still under a special duty, in view of its expert knowledge and proffered advice, not to take advantage of its customers' ignorance of market condition. The key to the success of all of petitioner's dealings was the confidence in itself which it managed to instill in the customers. Once that confidence was established, the failure to reveal the mark-up pocketed by the firm was both an omission to state a material fact and a fraudulent device. When nothing was said about market price, the natural implication in the untutored minds of the purchasers was that the price asked was close to the market. The law of fraud knows no difference between express representation on the

> one hand and implied misrepresentation or concealment on the other.

Id. at 437 (citations omitted).

Subsequently, in *Norris & Hirshberg, Inc.*, 21 S.E.C. 865 (1946), *aff'd*, 177 F.2d 228 (D.C. Cir. 1949), the Commission reviewed the practices of a broker-dealer who traded with customers in securities that had no market, stating:

> [w]hile many of the classic manipulative techniques may not have been used, the vice inherent in respondent's purchases and sales without full disclosure of the fact that the market was dominated by respondent is the same as that inherent in a classic manipulation: The substitution of a private system of pricing for the collective judgment of buyers and sellers in an open market.
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> * * *
>
> Each of respondent's sales carried with it the clear—though implied—representation that the price was reasonably related to that prevailing in an open market [citing *Duker & Duker and Charles Hughes & Co.*]. Without disclosure fully revealing that the "market" was an internal system created, controlled, and dominated by the respondent that representation was materially false and misleading.

21 S.E.C. at 881, 882. *See also S.T. Jackson & Co., Inc.*, 36 S.E.C. 631, 654 (1950); *Halsey, Stuart & Co., Inc.*, 30 S.E.C. 106, 112 (1949). And if there are two "markets" for a security, sellers of securities "ha[ve] the right to know that the defendants [are] in a position to gain financially from their sales and that their shares were selling for a higher price in [the second] market." *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128, 153, *reh'g denied*, 407 U.S. 916 (1972).

SEC v. *Rega*, [1975-76 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 95,222 (S.D.N.Y. July 3, 1975), *aff'd in part, rev'd in part on other grounds sub. nom. SEC* v. *Coven*, 581 F.2d 1020 (2d Cir. 1978), *cert. denied*, 440 U.S. 950 (1979), applied the

foregoing principles in the context of a public offering of securities and aftermarket trading of those securities. There, Carlton-Cambridge & Co., a broker-dealer, through its president, Joseph Rega, underwrote and then traded in the securities of a company called Dennison Personnel, Inc. The parallels to First Jersey here are striking.

> There is no question that during the period from June to October 1972 Rega and Carlton controlled the market in Dennison. This domination was greatly facilitated by the fact that a substantial percentage of the Dennison issue—allegedly 2,727,000 shares of 3,073,500 shares issued—were in the hands of Carlton's customers. These customers sold to and purchased Dennison from Carlton at prices set by Rega. Given Carlton's total dominance of the market the scheme worked quite effectively. Carlton initially sold "short" to its customers and purchased the shares from its customers at lower prices to cover its short position. Also Carlton just cross-traded customers sell and buy orders, resulting, of course, in a nice profit for the firm. As a result of all this Carlton was a market unto itself making it appear that in fact there was an independent and free market in Dennison rather than the contrived artificial market which in fact it was.

Id. at ¶ 98,146. The Court, citing *Charles Hughes & Co.*, had no difficulty in concluding that defendants violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. *Id.*

Accordingly, there is no question that First Jersey's sales practices violated Sections 17(a), 10(b), and Rule 10b-5.

Next, the evidence overwhelmingly established that the defendants wilfully and deliberately violated established law forbidding excessive markups as well.

The starting point in determining the legality or illegality of a broker's markup on a sale of stock is the establishment, from the best available evidence, of the prevailing market price, *see*,

e.g., *Alstead, Dempsey & Company, Inc.*, 30 S.E.C. Docket 208 (1984). This is a factual, not a legal search.

Having made such a determination, under the law, a broker-dealer who charges his customer an undisclosed markup of more than 10% above the prevailing market price for an equity security commits securities fraud per se. *See, e.g.*, *Peter J. Kisch*, 25 S.E.C. Docket 1242 (1982); *Powell* v. *Associates*, 24 S.E.C. Docket 1577 (1982); *James E. Ryan*, 24 S.E.C. Docket 1716 (1982), *aff'd*, *James E. Ryan* v. *SEC*, No. 82-7312 (9th Cir. Feb. 10, 1983); *Sherman Gleason*, 15 S.E.C. 639, 651 (1944).

While the markup on a broker-dealer's sale to its customer is calculated by subtracting the "prevailing market price" for the security from the price charged to the customer, under case law, the "prevailing market price", the starting point for a markup assessment, is determined differently depending on a number of factors, including the nature of the market for the security and whether or not the broker-dealer is or is not a "market maker" in that security. A "market maker" in a security is a broker-dealer who holds itself out to the broker-dealer community as standing ready to purchase and sell that security at particular quoted bid and asked prices and who does, as proved by actual transactions, make a continuous, two-sided market in that security.[19/]

Accordingly, the guidelines for determining prevailing market price as summarized in *Zero Coupon Securities* Release No. 34-24368 (Apr. 29, 1987), are, as a general matter, as follows:

> The best evidence of the prevailing market price for a broker-dealer who is not making a market in the security is that dealer's contemporaneous cost of acquiring a security. For

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[19/] 15 U.S.C. § 78c(a)38 (1993) defines "market maker" as follows:

> The term "market maker" means . . . any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.

However, mere listing in the "pink sheets" as they are called, does not, as First Jersey claims, a "market maker make."

a broker-dealer who acts as an "integrated market maker" in a security—i.e., one who both makes a market in a security and in addition sells it to retail customers—the best evidence of prevailing market price generally is contemporaneous sales by the firm (or by other market makers) to other securities dealers.

For securities that are actively traded between dealers, those dealers' "ask" quotations may be used to gauge prevailing market price *if* the quotations have been validated by actual transactions; for securities not actively traded between dealers, actual transactions must be looked to for the prevailing market price, because quotations in an inactive market are frequently nothing more than invitations to negotiate a price.

Where, however, a security is not only inactively traded between dealers, but a competitive market does not exist because that market is "dominated" by a single dealer, the use of market maker sales or quotations is likely to be impractical or misleading. In such a "dominated" market, the best evidence of prevailing market price is the dealer's contemporaneous cost, which is either the price that the dealer paid to other dealers, or the price that the dealer paid to its retail customers to acquire the security (after an adjustment that allows the dealer a markdown[20/] on purchases from customers).

[20/] When purchasing securities for its own account from a retail customer, a broker-dealer generally does not commit fraud if it pays the customer a price that is ten percent *less* than the prevailing market price for that security. This ten percent reduction is called a "markdown", as distinct from a "markup," which refers to an additional increment over the prevailing market price that a broker-dealer charges to a customer who is *buying* a security from the broker-dealer.

The purpose of these common sense requirements is to prevent overreaching against retail customers. When they are violated, a broker-dealer commits securities fraud. Here, First Jersey was not a market maker since it did not, in the broker-dealer community, make a continuous two-sided market in any security that was in issue on this trial. Further, it dominated and controlled the trading in each of the nine securities at issue. Accordingly, First Jersey was required to price its retail sales to its customers based on its contemporaneous cost to acquire the securities. And, as stated in *Meyer Blinder*, 52 S.E.C. 1145, n.17 (1992):

> In determining the prevailing market price for a stock, we and the courts have held that there is a presumption that a dealer's own contemporaneous cost in acquiring the stock it sells to its customers is a fair representation of the stock's prevailing market price. *Barnett* v. *U.S.*, 319 F.2d 340, 344 (8th Cir. 1963).

Contentions of Defendants' Experts

While from the testimony of First Jersey's salesmen themselves, thoroughly supported by First Jersey's trading records and commission runs, as well as by much other collateral evidence, the obvious conclusions above are mandated, some comment is appropriate to dispel any clouds that expert witnesses for the defense endeavored to create.

Defense witness attorney Peter Shaeffer, presented on markup issues, testified that he was only able to deal with market calculations on four of the nine securities at issue, and even as to those had to acknowledge that First Jersey had charged $243,619 in excessive markups. His effort to blunt the SEC's position required him to espouse two contentions. One was that in 1982, and until 1992, the use of retail purchases by a broker-dealer as the bench mark for calculating markups was not known to the law and the other was that this bench mark, which he asserted emerged in 1992, even then could only be used in circumstances where there were *no* interdealer market purchases to look to for the prevailing market price. Neither of these conclusions, however, has support. First, there *were* markup cases decided by the SEC as far back as

1960 and 1961 using retail purchase prices as bench marks for calculating markups. *See Amsbary, Allen & Morton, Inc.*, 42 S.E.C. 919, 920 (1966); *Manthos, Moss & Co., Inc.*, 40 S.E.C. 542, 544 (1961); *W.T. Anderson & Co.*, 39 S.E.C. 630, 634 (1960).

Second, Shaeffer was in error contending that under the law a broker-dealer may only use its own retail purchases as a bench mark where there are *no* interdealer market purchases by any dealer with any other dealer, or, stated conversely, that if there are *any* transactions between *any* dealers, those alone must be looked to regardless of whatever and how many transactions the broker-dealer in question is contemporaneously having with its own customers. Not only is this not the law, but it does not accord with the factual realities in the market place. The use of contemporaneous interdealer purchases which the law requires be looked to first for prevailing market price are purchases *by the broker-dealer in question* from other dealers, *see Meyer Blinder, supra*. If the dealer in question has no contemporaneous purchases *from anyone, other dealers or its customers*, then contemporaneous interdealer transactions by others may be examined *as some evidence* of the prevailing market price for lack of any other bench mark. *Bison Securities*, Release No. 34-32034 (Mar. 23, 1993).

Thus, I cannot accept Shaeffer's conclusion that where First Jersey had enormous contemporaneous purchases from its own customers but made no significant purchases in the interdealer market, it can disregard the prices at which it purchased from its thousands of customers and look retrospectively to a transaction here or there of other dealers to now assert before the Court a "prevailing market price" against which *its* markups are to be viewed. And this, as noted, is also factually flawed in that a broker-dealer such as First Jersey as to a pink sheet/over-the-counter stock would not know the prices of interdealer transactions "away" from it for long periods of time after the fact, and therefore it was impossible for its trading department to have used such "away" transactions in making a contemporaneous

determinations as to its own retail sales prices.[21/] And Shaeffer's legal assertion is obviously in conflict with the very straightforward statement in *Meyer Blinder* itself, 52 S.E.C. at n.17 (quoted *supra*).

Further, Shaeffer, to support his analysis, had to assert that as to certain of the securities in issue, First Jersey was a market-maker and therefore could pick and choose from not only its own interdealer sales transactions, but also from "away" transactions by other dealers in a hindsight search for the most advantageous transaction price to proffer to the court in defense of the markups at issue here. However, it is clear that under the tests catalogued in *zero coupon securities*, *supra* that in no instance was First Jersey a market-maker in any of the securities in issue. Appropriate here is the Commission's observation in *Sacks Investment Company* that:

> to be treated as a market maker, a dealer must, among other things, advertise its willingness to buy and sell securities for its own account and stand ready to buy and sell to other dealers at its quoted prices. Merely buying shares from other dealers for resale to customers does not qualify a broker-dealer as a market maker.
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> * * *
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> We have previously noted, however, that listing in the pink sheets is not dispositive of a dealer's status as a market maker. The dealer must be engaged in wholesale trading activity in the security in question.

54 S.E.C. Docket 784, 787-88 n.11 (footnote omitted). And in *Century Capital Corp.*, 54 S.E.C. Docket 685, 688 n.9, the Commission observed that "We have consistently rejected the notion that a firm is acting as a market maker when it is merely

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[21/] Again, as I noted *supra*, the Court never heard from head trader Nadino, or anyone else at First Jersey, as to how prices were in fact established in the trading department as to any sales at issue in this case. And, I further note that defense expert Shaeffer never asked anybody at First Jersey how it arrived at its markups in this case, and accordingly, professed no knowledge on that subject.

engaged in acquiring shares from other dealers for resale to its retail customers"—precisely what First Jersey was doing. Sporadic and relatively insubstantial dealer sales do not suffice to afford First Jersey market maker status.

One further error in Shaeffer's analysis needs to be observed. To reach his conclusions, even as to those securities for which he did perform a market analysis, it was necessary for him to assert that First Jersey did not dominate and control trading in order to avoid the impact of the "contemporaneous cost" standard. This he sought to accomplish by entirely focusing on First Jersey's percentage of the interdealer trading, completely disregarding its massive retail trading. However, this flies in the face of common sense and the rule of *Alstead Dempsey* which looks at the entire market, including transactions with both customers and other dealers. And under that rule, First Jersey's percentages of the market in all cases were higher than the 86% *Alstead Dempsey* found to constitute control. Accordingly, Shaeffer's conclusions regarding calculations of markups are rejected on both factual and legal grounds.

Next, as to five of the nine securities in issue, First Jersey and Brennan took the position that one could not apply traditional markup analysis, since there were not sufficient interdealer transactions to support it. As to those five, their expert, Professor Gregg Jarrell, had two contentions. First, that the cost of repurchasing the units could not be used to compute prevailing market prices for components because a unit is fundamentally different from its components, and second, that First Jersey's sales prices to customers were "fair" when viewed against what Jarrell asserted was their "value". These assertions, for various reasons, do not survive analysis. First, First Jersey and Brennan never gave a thought to this issue at the time the units were repurchased and the components sold, always regarding the units sold in the underwritings and immediately bought back as already being components available for sale even at the time of the underwriting, and accordingly, the argument as to the alleged illiquidity of units as compared to the liquidity of the stock, even if it has validity in

other circumstances, has no validity here.[22/] Second, First Jersey at the time never gave a thought to the liquidity question, making its own determination as to the price at which it would sell the components of the units it was reacquiring.[23/]

[22/] In this regard, defense expert Shaeffer's testimony on cross-examination on a collateral subject was damagingly illuminating:

> Q. You agree, do you not, Mr. Shaeffer, that a rational unit purchaser in any of the unit offerings here at issue would not sell his unit back to First Jersey at the price First Jersey offered if the unit purchaser knew that First Jersey was going to immediately split the unit into its components and sell them off at twice that price, as it did, for example, in Quasar?
>
> A. I agree with that.

[23/] The defense also attacked the "unit cost allocation" which the SEC has applied here in assigning contemporaneous cost to the units' components. This formula, simply described, works as follows:

> If a unit consists of two shares of common and one warrant, and First Jersey buys it back from a customer for $1 and then sells the common at $.75 a share and the warrant at $.50, the First Jersey sales price for a unit equivalent is:
>
> | | | |
> |---|---|---|
> | 2 Common @ $.75 | = | $1.50 |
> | 1 Warrant @ .50 | = | .50 |
> | Total | | $2.00 |
>
> Thus, under the allocation formula, 1 share of common is 37.5% of the unit equivalent and 1 warrant is 25%. Applying that percentage to the acquisition cost of the unit, each share of common has a cost basis of $.375 and each warrant $.25. The unit allocation cost formula not only comports with common sense but is also consistent with language that First Jersey put in such documents as the Quasar prospectus which states at p. 27 under "Tax Considerations Regarding Units", that "The cost of each unit will be allocated among each of its elements (three shares of common stock and one warrant) in accordance with their relative fair market values to determine the adjusted basis of each such element for Federal income tax purposes." And Exchange Act Rule 10b-7(j)(7), regarding stabilization activities by underwriters, provides in pertinent part that
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> > When two or more securities are being offered as a unit, the component securities shall not be stabilized at prices the sum of
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> (continued...)

Next, as to Jarrell's contention that as to each security for which Shaeffer was unable to ascertain and urge a prevailing market price, the sales price was "fair", I observe that first, there was no testimony in this case that anybody at First Jersey ever established a resale price based on some asserted analysis of fairness, and second, even if that had occurred, it is irrelevant. The test is not whether a stock is sold at a price that some analyst might believe is fair, but whether or not, as was held in *Charles Hughes* v. *S.E.C.*, it was sold at a price reasonably related to that prevailing in the market, which is what an untutored customer was entitled to expect, and not at a price that First Jersey's trading room arbitrarily established knowing it controlled and dominated the market.

Accordingly, Jarrell's efforts to give validity to First Jersey's conduct in this situation fails.

Brennan's Personal Responsibility

The proof at trial showed plainly that Brennan was a "hands-on" manager who was intimately involved in the operations of First Jersey, including all significant decisions regarding the firm's underwriting, retail sales and trading activities. Brennan signed every one of the underwriting agreements at issue in this case and admitted that he "typically" participated in the key decision to split "units" into their component securities.

In his trial testimony Brennan—never denied knowing that First Jersey had repeatedly underwritten "units", and bought the units back from its customers, and had broken up the units, and resold the components to other customers without disclosing the price at which it had repurchased the units. To the contrary, he defended those transactions, taking the position that First Jersey's

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[2] (...continued)

> which exceeds the offering price of the unit.

Nor do I find it a bar to the application of such unit cost allocation, that it has not received prior judicial imprimatur. It has a sound basis not only in economics but also in the factual setting this record has put before me. I accept it and apply it.

massive and repeated oversales and repurchases of units were, essentially, accidental, and that the firm's unit repurchases and the prices at which they were acquired, were not material to the customers who bought the components.[24/]

Brennan was the 100% owner of First Jersey throughout the relevant period and received periodic reports on First Jersey's positions in the various securities that it traded, which one would expect given the fact that every major trading decision by First Jersey went directly to Brennan's bottom line. As Roger Barnett, now its President, testified with respect to First Jersey's commission practices, "if [Brennan] insisted on it and he didn't listen to anyone else, he could have made any decision he wanted to."

Brennan, while testifying as a hostile witness in the plaintiff's case, did not testify in defendants' case and never contended that the sales practice and markup violations proved at trial were due to the unauthorized actions of other executives at First Jersey. Such a contention would in any event have been completely undercut by defendants' failure to call as witnesses anyone from First Jersey's Trading Department including Anthony Nadino, its head trader at all relevant times here with whom Brennan is still connected (*infra*), nor did defendants call John Dell, who was the head of First Jersey's Sales Department. Taking into account all the facts and circumstances bearing upon those witnesses' relations to the parties, the Court is entitled to infer that the testimony of Nadino and Dell would have been unfavorable to

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[24/] Since, as the trial record makes clear (Brennan's testimony to the contrary notwithstanding), Brennan at all times regarded the units and their components as one and the same, Brennan's exchange with the Court on a collateral subject is illuminating:

> THE COURT: Suppose First Jersey, had in fact bought the common at $1 a share on the 19th. . . . It then sells that common at 2¼ a share on the 22nd. Would you regard telling the customer the fact that we picked it up three days ago at $1 to be a material fact in connection with that sale?
> THE WITNESS: It is not material, it is irrelevant to the customer.

Brennan and First Jersey. *See, e.g., United States* v. *Torres*, 845 F.2d 1165, 1169-70 (2d Cir. 1988).

Thus, the evidence compels the conclusion than that Brennan is primarily liable with First Jersey for the securities violations in this case.

Brennan is also jointly and severally liable for First Jersey's violations of Exchange Act Section 10(b) and Rule 10b-5 because Brennan was a "control person" of First Jersey. Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a) (1993) provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

I have already ruled that the Commission has standing to proceed under § 20(a) of the Exchange Act. *See SEC* v. *First Jersey Securities, Inc.*, 376 F. Supp. 488 (S.D.N.Y. 1994). Section 20(a) permits a plaintiff who can plead and prove a securities violation by a "controlled" person to shift to the "controlling" defendant the burden of proving that he acted in good faith and did not, directly or indirectly, induce the violation. The requisite control can be shown by a number of factors, including stock ownership, an employment or supervisory relationship, or the receipt of commissions on the controlled person's securities transactions.

This burden-shifting of § 20(a) has found approval in *Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980), where the Court stated that:

> . . . While the precise standard of supervision required of broker-dealers to make good the good faith defense of § 20(a) is uncertain, where, as in the present case, the erring salesman

> completes the transactions through the employing brokerage house and the brokerage house receives a commission on the transactions, the burden of proving good faith is shifted to the brokerage house. . . .

Id. at 716 (citations omitted).

Following *Marbury*, and consistent with the plain language of the statute, the weight of authority, which I follow, holds that once a plaintiff has proved a primary violation of the securities laws, as well as the fact that the primary violator was controlled by another, sometimes referred to as "control by status", § 20(a) shifts to the controlling person the burden of proving that he should not share the liability of the primary violator. *Food and Allied Service Trades Dep't., AFL-CIO* v. *Millfeld Trading Co., Inc.*, 841 F. Supp. 1386, 1389-91 (S.D.N.Y. 1994); *Mecca* v. *Gibraltar Corp.*, 746 F. Supp. 338, 347-48 (S.D.N.Y. 1990); *Borden, Inc.* v. *Spoor Behrins Campbell & Young*, 735 F. Supp. 587, 588-91 (S.D.N.Y. 1990).

Thus, as president, chief executive officer, director, and sole shareholder of First Jersey, Brennan possessed control over every aspect of First Jersey's operations. Indeed, Brennan at trial virtually conceded that he was a controlling person of First Jersey for purposes of § 20(a). Accordingly, the Commission has more than made out a *prima facie* case of "control person" liability on Brennan's part.

Section 20(a) provides that a controlling person may escape liability if he can show that he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." As previously noted, the burden of proof with respect to this defense lies with Brennan. *Marbury Mgmt. Inc.* v. *Kohn*, 629 F.2d at 716; *see also Hollinger* v. *Titan Capital Corp.*, 914 F.2d 1564, 1575 & n.25 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991).

In the ordinary case involving erring securities salesmen, the controlling defendant must "show at least that [he] has not been negligent in supervision . . . and that [he] has maintained and enforced a reasonable and proper system of supervision and internal

control over sales personnel. . . ." *Marbury Mgmt.*, 629 F.2d at 716.

In this case, as in *Drobbin*, 631 F. Supp. at 886, I need not decide whether defendant Brennan was required to rebut negligence or merely to establish that he did not act recklessly; Brennan's proof fails to demonstrate "good faith" and non-inducement under any standard. *Hollinger* v. *Titan Capital Corp.* makes clear that simply *having* procedural manuals on a bookshelf, as First Jersey did, is insufficient to support a "good faith" defense.[25] Those supervisory procedures must be shown to have been adequate and enforced by the "controlling" defendant:

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[25] As the testimony before me revealed, First Jersey's procedural manuals were hardly more than "window dressing". The salesmen were not directed to follow them; they didn't follow them; and some hardly knew they existed. Equally "window-dressing" were such things as First Jersey's annual questionnaires the salesmen were required to answer. "Correct" answers were regarded as a condition of employment. Significantly, one of First Jersey's branch managers, Leonard Alsfeld, testified:

> THE COURT: Take [questionnaire question] 21, "Have you always told your customers all the material facts about a company prior to purchase and sale order?" Did anybody ever answer that "no"?
>
> THE WITNESS: Never.
>
> THE COURT: Question 22. "Throughout your employment at First Jersey, has First Jersey management always required you to learn your customers' financial objectives and circumstances prior to your making any purchase offer sale recommendation?" Did anybody ever answer that "no"?
>
> THE WITNESS: No, sir.
>
> * * *
>
> THE COURT: You said, look, you have to tell your customers all about the material facts here, all about the risk. Suppose he doesn't do it. Do you think he is going to put down "no" in answer to this? ... You would fire him in two minutes, right?
>
> THE WITNESS: Those are valid points.

> [T]he broker-dealer cannot satisfy its burden of proving good faith merely by saying that it has supervisory procedures in place, and therefore, it has fulfilled its duty to supervise. A broker-dealer can establish the good faith defense only by proving that it "maintained and enforced a reasonable and proper system of supervision and internal control". Accordingly, the district court erred in ruling that because "Titan had adopted rules for accepting investment payments and for supervising a contractor's compliance with securities laws and regulations," it had satisfied its duty to supervise. . . . Should Titan choose to rely upon the good faith defense, then it must carry its burden of persuasion that its supervisory system was adequate and that it reasonably discharged its responsibilities under the system.

Hollinger, 914 F.2d at 1576 (citations omitted).

In this case, First Jersey's compliance procedures and manuals were never intended for more than appearances should an occasion such as this arise. Eyerman, First Jersey's Director of Compliance, though not conceding that the illegal markups were made, acknowledged that in any event, the firm's procedures for reviewing markups would never have detected the enormous illegal markups which, it is clear, were made here.

First Jersey and Brennan's Regulatory Agency Brushes

Highly material to determining the relief appropriate here is the fact that over many years there have been numerous other securities regulatory proceedings involving First Jersey, Brennan and other principals and associates.

From July 8 until August 7, 1973, Brennan was suspended from the sale of mutual funds by the New Jersey Bureau of Securities. Anthony Nadino, head trader for First Jersey at all times relevant to this case, was Brennan's brother-in-law, and in 1974, Nadino was federally enjoined from further violations of the antifraud provisions of the securities laws based upon his promulgation of false and misleading quotations and manipulation

of the market while employed at another broker-dealer prior to coming to First Jersey. *SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801, 810-11, 814 (2d Cir. 1975). Brennan was aware of this when he hired Nadino to work at First Jersey. In 1984, First Jersey and Brennan consented to the entry of Final Judgments of Permanent Injunction by Consent in *SEC* v. *First Jersey Sec., Inc., Robert E. Brennan, et ano*, No. 83 Civ. 0483 (MP) (S.D.N.Y. Nov. 20, 1984), in which First Jersey and Brennan were

> permanently enjoined, directly or indirectly, by the use of any means of instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with a particular distribution of any security, either alone or with one or more other persons, from bidding for or purchasing for any account in which [defendant] has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right until after [defendant] has completed [defendant's] participation in such distribution, in violation of § 10(b) of the Exchange Act, 15 U.S.C. 78j(b), as defined by Rule 10b-6, as amended, 17 C.F.R. § 240.10b-6 thereunder.

First Jersey was also ordered to permit a court-appointed consultant to review First Jersey's sales practices, business operations and supervisory procedures and to implement the consultant's recommendations following his review.

In 1986, the National Association of Securities Dealers accepted an offer of settlement in a proceeding entitled *Market Surveillance Committee* v. *First Jersey Sec., Inc., Robert E. Brennan, and Anthony Nadino*, Complaint No. MS-261, concerning markups in Transnet warrants, in which (1) Brennan was censured, fined $25,000, and suspended from being associated with any NASD member for 10 business days in all capacities; (2) Nadino was censured, fined $25,000, and suspended from being associated with any NASD member for 10 business days in all capacities;

(3) First Jersey was censured, fined $300,000, and obligated to promptly implement the recommendations of the Consultant appointed in *SEC* v. *First Jersey and Brennan*, *supra*.

During 1987, defendants First Jersey, Robert E. Brennan, and John Dell entered into a Stipulation of Settlement in an action entitled *Spatola, et al.* v. *First Jersey Securities, et al.*, M.D.L. No. 681, No. 85 Civ. 6059 (E.D. Pa. 1987), alleging that defendants created actual or apparent active trading in, charged excessive markups and markdowns in, and artificially inflated the price of, securities sold by First Jersey, in which First Jersey agreed to pay $10,000,000 to the plaintiff class.

In 1990, the NASD accepted an offer of settlement in a proceeding entitled *District Business Conduct Committee* v. *First Jersey Securities, Inc., Robert E. Brennan, John E. Dell, Frederick A. Eyerman, et al.*, Complaint No. NEW-619 (Sept. 24, 1990), concerning violations of the NASD's Rules of Fair Practice, in which (1) First Jersey was censured and fined $50,000, and (2) Brennan, Dell, and Eyerman were censured.

First Jersey's Securities Activities Since January 31, 1987.[26]

Following January 30, 1987, when it sold the bulk of its retail offices to Sherwood Capital Corporation, First Jersey continued to be a broker-dealer registered with the Commission pursuant to § 15 of the Exchange Act, and it and Brennan continue to maintain offices at 50 Broadway in New York City. In April 1987, Roger Barnett, formerly the secretary-treasurer and chief financial officer of First Jersey, became President of First Jersey.

Since January 31, 1987, First Jersey has continued to buy and sell securities for its own account with "Dealer Inventory and Investment Gains" in some years in the millions.

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[26] Up to February 22, 1995, when First Jersey *after* closing arguments before me filed a "Request for Withdrawal from Broker-Dealer Registration" with the SEC, and NASD, but obviously with this ruling *sub judice*, I note that on the form in response to the question, "Is [First Jersey] now the subject of . . . any complaint. . . ?" First Jersey's present president Roger Barnett has submitted the sworn answer, "No."

On January 17, 1991, First Jersey extended a $400,000 loan to Franklin N. Wolf, the President of the brokerage firm F.N. Wolf & Co. On September 3, 1991, First Jersey paid $4,300,000 to Hibbard Brown & Co., a broker-dealer (which firm figures prominently in a transaction set forth hereafter) for the purchase of securities by Brennan. On September 16, 1991, First Jersey extended a $300,000 loan to Hibbard Brown & Co.

Brennan's Securities Activities Since January 31, 1987

Since January 31, 1987, Brennan has continued to own 100 percent of the issued and outstanding stock of First Jersey and continued to be a director of First Jersey. Until November 4, 1993, Brennan continued to be registered with the NASD as a person associated with First Jersey. Brennan is the sole shareholder, a director, and President/Treasurer, and Barnett is Vice President/Secretary, of Austin Bernet, Inc., a New Jersey corporation with its principal place of business at 340 North Avenue, Cranford, New Jersey. Brennan and Barnett are the sole officers and directors and make all decisions on behalf of Austin Bernet (whose activities are extensively detailed hereafter).

In 1988, Hibbard Brown & Co. purchased from Sherwood Securities the retail offices that First Jersey had sold to Sherwood in 1987, and also assumed Sherwood's obligation to maintain First Jersey's and Brennan's office space at 50 Broadway. Austin Bernet, with Brennan's approval, has made overnight broker loans to Hibbard Brown and has also extended longer-term loans to Hibbard Brown for as much as $4.5 million. In 1988, Brennan initially discussed with Peter Hibbard, a principal of Hibbard Brown, a possible investment by Brennan in Hibbard Brown. That investment was not made; however, in mid-1988, Brennan personally lent some $5 million to George Stamos for the purpose of assisting in Stamos' investment in Hibbard Brown. Stamos, who had represented Brennan in various projects, had been one of the first investors in First Jersey in the 1970s. Several months after the said loan to Stamos, Mickey Hart, another associate of Brennan, assumed the equity portion of Stamos' investment in Hibbard Brown as well as approximately $2 million of Stamos' debt to Brennan. Brennan, through Austin Bernet, also provided more than $200,000 in collateral to Leonard Greer, who had handled the First

Jersey account at Paine Webber at a time when Greer was seeking to purchase L.C. Wegard & Co., another securities brokerage firm. Companies in which Brennan has an interest have lent money, ranging from a few hundred thousand dollars to $1-2 million, to L.C. Wegard since Greer took the firm over. On August 20, 1991, Austin Bernet sold Leonard Greer 350,000 common stock purchase warrants of Site-Based Media, Inc. in exchange for a $400,000 promissory note from Greer. On that same day, Austin Bernet also sold Greer 300,000 shares of Nacoma Consolidated Industries, Inc. in exchange for a $600,000 promissory note from Mr. Greer. On November 25, 1991, Austin Bernet repurchased the 350,000 Site-Based warrants from Mr. Greer for $2,100,000 and Greer repaid both of his August 1991 promissory notes. On July 26, 1993, Austin Bernet sold L.C. Wegard 100,000 shares of Sanyo Industries, Inc. for $300,000 plus 200,000 warrants of U.S. Transportation Systems, Inc. and 500,000 common shares of Thermodynetics, Inc. Brennan closed his July 26, 1993 letter to L.C. Wegard confirming that transaction by stating:

> As we discussed, we would be happy to entertain "size" bids on Creative Resources, Poseidon Pools, Dreamcar Holdings, News Communications, Stateswest Airlines and International Microelectronic Products. These securities are available subject to prior sale. Please let us know if you need any additional information about any of these companies.

Brennan is the controlling stockholder and a director of FJS Properties, Inc., which is the managing general partner of FJS Properties Fund I.L.P., a publicly-owned entity.

Brennan is the owner, president, and a director of Due Process Stable. In September 1991, Due Process Stable sold Hibbard Brown 22,000 options entitling the firm to buy 2.2 million shares of Site-Based Media, Inc. In October, Due Process Stable sold Hibbard Brown additional options entitling the firm to buy 4.4 million Site-Based warrants.

Brennan is the Chief Executive Officer and sole shareholder of Hartley Bush Financial Corp. Hartley Bush, a New Jersey

corporation has its principal place of business at 340 North Avenue, Cranford, New Jersey, where Austin Bernet has its offices.

Brennan is Chairman of the Board of International Thoroughbred Breeders, Inc. ("ITB"), a publicly-held corporation which trades on the American Stock Exchange. As of December 30, 1992 Brennan was Chief Executive Officer as well as Chairman of ITB, and owned 4.3 million shares of the company's stock.

On June 19, 1987, Brennan acquired 16,899,000 shares or 46.1% of the common stock of Chefs International, Inc., a publicly-owned company in whose securities First Jersey made a market. As of June 29, 1990, Brennan owned 17,399,000 shares of Chefs International common stock and is its largest shareholder. As of August 1993, Brennan was effectively able to elect all of Chefs' directors and control its affairs. In the summer of 1993, Brennan recommended that Chefs make a unit offering and assisted Chefs in finding an underwriter.

On February 19, 1991, Brennan acquired 16,000,000 shares of the common stock of CCC Franchising Corporation. Brennan thus became the majority shareholder of CCC Franchising. CCC Franchising is a publicly-held company that trades on NASDAQ. The President of CCC Franchising is Andrew C. Alson, who is also the President of FJS Properties, Inc. mentioned above. Brennan has personally guaranteed obligations of CCC Franchising, including its notes for a corporate acquisition. Brennan sold 2,000,000 of his CCC common shares in May 1991, 2,000,000 more in December 1991, 400,000 more in April 1992, and 300,000 more in September 1992. In February 1992 Brennan, through Hartley Bush, received 5,000,000 warrants to purchase common stock of CCC Franchising as consideration for the posting, by a corporation wholly owned by Brennan, of collateral for a $30,000,000 bank loan to a wholly-owned subsidiary of CCC. In May 1992, Hartley Bush distributed those 5,000,000 warrants to Brennan. In June 1992, Brennan received an additional 2,000,000 warrants to purchase CCC Franchising common stock as consideration for the delivery of Brennan's guaranty with respect to a $20,000,000 obligation of CCC. As of October 1992, Brennan owned 46% of the common stock of CCC Franchising. In January

1993, Brennan participated in a public offering by CCC Franchising of 7.5 million shares, underwritten by F.N. Wolf & Co. Brennan is still a major shareholder of CCC Franchising today.

During 1991, CCC Franchising loaned money to Digital Products Corp. In June 1993, CCC Franchising, which had owned various securities of Digital Products since January 1991, sold 1,100,000 warrants to purchase Digital Products common stock at $1.25 per share, plus 1,000,000 shares of Digital Products common stock, to Digital Products for $10,000,000 plus 2,000,000 warrants to purchase Digital Products common stock at $0.00 per share. Brennan played a significant role in CCC Franchising's acquisition of Primedex Corporation (of which more hereafter) including introducing two of Primedex's officers to CCC Franchising, performing some of the "due diligence" for the acquisition, and putting up a substantial percentage of the purchase price. On November 20, 1992, CCC Franchising changed its name to Primedex Health Systems, Inc. Roger Barnett was installed as an officer of Primedex. As of May 28, 1993, Primedex was the majority shareholder of Immunotherapeutics, Inc., which is a publicly-held company that trades on the over-the-counter market.

On October 25, 1991, Austin Bernet purchased 314,325 shares, or 9.9%, of the common stock of First State Financial Services, Inc. From at least February 23, 1991 until at least May 29, 1992, Austin Bernet maintained a securities trading account at Dominick & Dominick, a registered broker-dealer, in which Austin Bernet bought and sold securities of Future Funding Corporation, Digital Products Corporation, Great American Recreation Inc., Site-Based Media Inc., S L Resources, Nacoma Consolidated Industries Inc., Officeland, Inc., Unified Capital, and Treats International Enterprises. From at least January 28, 1991 through at least September 27, 1991, Austin Bernet maintained a securities trading account at Adler, Coleman & Co., Inc., a broker-dealer, in which Austin Bernet purchased and sold securities of Future Funding Corp., Nacoma Consolidated Industries, PDK Labs, Inc., and Site-Based Media Inc. As of March 6, 1992, Brennan owned 2,458,663 shares of the common stock of Bally Manufacturing Corporation, a publicly-owned company.

On May 19, 1992, the Securities and Exchange Commission issued an order suspending trading in the securities of Treats International Enterprises, Inc. because of a lack of current and accurate information regarding the identity of persons having undisclosed control of the company and beneficial ownership of the company's securities. Thereafter, Treats filed a Form 10-K which disclosed that Austin Bernet and three Brennan family trusts owned, in the aggregate, 96% of Treats's Class A warrants, 96% of Treats' Class B warrants, and 6.67% of Treats' common stock. During 1992 or early 1993 Austin Bernet loaned Treats approximately $1 million. As of June 30, 1993, Austin Bernet and the Brennan family trust collectively owned 4,656,998 shares, or 23.95% of Treat's common stock. On November 6, 1992, the New Jersey Bureau of Securities withdrew the exemption under which Treats securities were sold in that state, on the ground, among others, that Brennan's interest in the company had not been disclosed.

During February and April 1991, Austin Bernet purchased 1,450,000 units of Future Funding Corporation at prices ranging from 10 cents to 11½ cents per unit. Thereafter, Future Funding Corporation changed its name to Site-Based Media, Inc. During August and September 1991, Austin Bernet sold the said 1,450,000 Site-Based units for $4.00 per unit through an intermediary to Hibbard Brown which not only has offices in Brennan's building but Hibbard Brown pays for the office space used by First Jersey, and where at that point Nadino was then Hibbard Brown's head trader.[27/] Finding illegal markups, the NASD ordered Brown to make restitution of some $8,700,000, and Nadino was fined $150,000 and barred from employment with any NASD member.[28/] The NASD Hearing Panel in its 1994 decision stated:

> We have no doubt of the responsibility for the mark-up violations by both [Brown and Nadino]. Rather, the evidence demonstrates that

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[27/] Austin Bernet also has a relationship with Hibbard Brown under which Austin Bernet loans it short-term money from time-to-time.

[28/] The authenticity of the NASD decision was conceded by defense counsel Dumont, Livelli and participating counsel Lowenfels.

> they engaged in retail sales to customers at inflated prices based upon their knowledge that they could purchase units from Brennan at the equivalent of $1.115 per share of common. HIBB's customers were purchasing SITE common, based upon the recommendation authorized by Brown at prices of $2.25 to $3 when both Brown and Nadino knew that the short would be covered by stock at $1.115.

The outlines of the foregoing findings of the NASD Hearing Panel were in fact acknowledged by Brennan on this trial notwithstanding his belligerent evasiveness over some 72 pages of cross-examination.[29/] Thus, I conclude without hesitation that Brennan knowingly negotiated the sale to Nadino of Site-Based Media units which were then broken out to cover Nadino's earlier short sales of common:

> THE COURT: I know the transactions may have been with Adler Coleman. But according to Mr. Nadino's [NASD] testimony, who is your brother-in-law, he negotiated the purchase of the units.
>
> THE WITNESS: He may have. I can't—he didn't negotiate with me.
>
> THE COURT: Are you telling me that you had no idea, when your brother-[in-law] was negotiating the purchase of these units, that the units were going to end up with your brother-in-law?
>
> THE WITNESS: Am I telling you that?
>
> THE COURT: Yes. Are you telling me that?
>
> THE WITNESS: I am telling you that, unequivocally.

[29/] This evasive attitude permeated Brennan's entire four days of testimony, starting at the very outset where he declined to recognize his signatures on First Jersey's application to become a broker-dealer, saying ". . . I can't be certain" and ". . . I don't recall it. . . ."

BY MR. KREITMAN:

Q. Mr. Brennan, who did you think Tony Nadino was representing in those negotiations?

A. I had no idea that Tony Nadino was representing anybody. I had no idea that Tony Nadino was involved in this particular sequence of transactions until many, many, months later, when an issue was raised that was heard by the NASD business district conduct committee.

Brennan acknowledged knowing that there was a subsequent adverse ruling by the NASD Panel as to Brown and Nadino. The foregoing was further supported on this trial by the records of Adler, Coleman & Co. The paralleling echoes of the transaction in the above Hibbard Brown case to the transactions in this case are patent, with clear applicability to the injunctive and disgorgement relief sought by the SEC herein.

The NASD Panel also observed that "Brennan, Brown and Nadino all denied that the purchase of units [from Brennan's Austin Bernet] was prearranged[,]" but rejected these denials,[20] as do I.

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[20] Brennan vigorously *agreed he had so denied*, and on this trial further denied he had even conferred with the defense before the NASD. He retracted this latter denial, however, when confronted with the transcript of the NASD hearing.

THE COURT: [Y]ou told us that you were a witness [before the NASD Panel]?
THE WITNESS: Yes, I was.
THE COURT: To say that the transaction had not been prearranged. Presumably, before you took the witness stand, you were discussing with lawyers and other people—and we had some discussion out here, Mr. Nadino is your brother-in-law, probably with Nadino, about what you were going to say when you got on the witness stand.
THE WITNESS: You are wrong on all accounts, Judge, you are wrong on all accounts. I didn't discuss it with any of the above. I went and gave testimony, because I was asked to appear.

But the next day, the NASD transcript was brought to Court and Brennan was confronted with his answer before that body which was as follows:

(continued...)

Taking all its trading in Site-Based Media together, Austin Bernet made a profit, according to Brennan on this trial, in excess of $25 million. In October 1992, the New Jersey State Bureau of Securities suspended trading in Site-Based shares in the State of New Jersey.

Austin Bernet and three Brennan family trusts have held positions in Sanyo Industries, Inc. In December 1992, the Securities and Exchange Commission suspended trading in Sanyo securities in view of questions about the adequacy and accuracy of publicly-disseminated information concerning, among other things, the identity of persons having control of Sanyo and the beneficial ownership of that company's securities.

As emerges from the foregoing, First Jersey may no longer be Brennan's first instrument of choice, but he has numerous other firms which he either owns, controls, or at which he has associations through which he has the power to and does continue his activities in the securities field, some cases still leading to state and federal suspensions of trading attributable to his conduct.

Conclusions of Law

This Court has jurisdiction over this action under § 22(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77v(a) (1993) and § 27 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78aa (1993). Certain of the transactions, acts, practices and courses of business complained of herein have occurred in the Southern District of New York and elsewhere, and venue is accordingly proper under § 22(a) of the Securities Act, 15 U.S.C. § 77v(a) (1993) and § 27 of the Exchange Act, 15 U.S.C. § 78aa (1993). Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), provides as follows:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or

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[20] (...continued)

> "I spoke with Brown and his counsel, and they interviewed with me for about a half an hour, and I met with them".

Whereupon he withdrew from his earlier answer and stated:

> "They did talk to me a half hour before I testified." . . .

instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), provides that

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated under § 10(b) of the Exchange Act, states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

The elements that the Commission must prove to show violations of these provisions are well established:

(1) a misrepresentation, or an omission (where there is a duty to speak), or other fraudulent device;

(2) in the offer or sale, or in connection with the purchase or sale, of a security; and

(3) materiality, in the case of any misrepresentation or omission.

For purposes of § 17(a)(1), § 10(b), and Rule 10b-5, the Commission also must prove scienter, amounting at least to

recklessness,[31] on the part of the defendants; no such showing is required to prove violations of § 17(a)(2) or 17(a)(3). *Aaron* v. *SEC*, 446 U.S. 680, 697, 701-02 (1980).[32] With respect to each of the substantive securities laws cited above, the Commission has satisfied the jurisdictional means: "the use of any means or instruments of transportation or communication in interstate commerce or . . . the use of the mails".

Plaintiff SEC has, as set forth above, overwhelmingly proven that defendants First Jersey and Brennan with respect to the sales and resales of securities involved herein to First Jersey customers violated § 17(a), § 10(b), and Rule 10b-5 in that with scienter, they deliberately used fraudulent devices in those transactions. Specifically, First Jersey's sales practices were intended by defendants to operate, and did operate, as a pervasive fraud on First Jersey's hundreds of thousands of retail customers, as has been delineated *supra*. I accordingly turn to remedies and relief.

Injunctive Relief

In actions such as this, the Commission appears "not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws." *SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975). As the Supreme Court has held with regard to an analogous regulatory statute, "the standards of the public interest not the requirements of private litigation measure the propriety and need for injunctive relief in these cases." *Hecht Co.* v. *Bowles*, 321 U.S. 321, 331 (1944) (referring to Emergency Price Control Act of 1942).

Among the factors to be considered by the Court in determining whether to grant injunctive relief are:

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[31] *See also IIT v. Cornfeld*, 619 F.2d 909, 923 (2d Cir. 1980).

[32] Unlike a private litigant, the Commission need not show reliance upon defendant's misrepresentation, omission, or fraudulent device, nor need the Commission show damages resulting therefrom. *See SEC* v. *Hasho*, 784 F. Supp. 1059, 1106 n. 11 (S.D.N.Y. 1992).

> the degree of scienter involved, the sincerity of defendant's assurances against future violations, the isolated or recurrent nature of the infraction, defendant's recognition of the wrongful nature of his conduct, and the likelihood, because of defendant's professional occupation, that future violations might occur.

SEC v. *Universal Major Indus. Corp.*, 546 F.2d 1044, 1048 (2d Cir. 1976), *cert. denied sub nom.*, *Homans* v. *SEC*, 434 U.S. 834 (1977).

On the clear evidence in this case, defendants' repeated violations of the securities laws were "flagrant and deliberate," as opposed to merely "technical in nature." *SEC* v. *First City Fin. Corp.*, 890 F.2d 1215, 1228 (D.C. Cir. 1989). Defendant Brennan and various former First Jersey colleagues have, over the intervening year continued to carry on business activities in the securities industry in substantial association with each other offending various federal and state securities laws, and Brennan is in a position to avail himself of future opportunities to do so.

Moreover, defendant Brennan is completely without remorse for the violations proven in this case, professing at trial that there was nothing wrong with First Jersey's pricing of the subject securities, and instead complaining that the prosecution of this action is "in a sick way, comical" and is "rooted in a malice and venom on the part of some people at the Commission".[33/]

[33/] These comments by Brennan on the witness stand before me, however, pale compared to his remarks, televised at a First Jersey staff dinner following the filing of this complaint, containing threats to SEC staff members and any of his own organization who turned against him:

> These people will be held accountable, and there's going to be no hiding and skirmishing. And I promise you one other thing, that if we have any people who have chosen to align themselves in a dishonest and irresponsible way with the SEC, we're going to hold them accountable, too. We're not going to let them hide behind the darkness of a barn door, and we're not going to let them hide behind anonymity. We're going to find them. We're going to locate them. We're going to put

(continued...)

These are relevant factors for the Court to weigh in determining the propriety of injunctive relief. *See SEC* v. *Savoy Indus., Inc.*, 587 F.2d 1149, 1168 (D.C. Cir. 1978), *cert. denied sub nom., Zimmerman* v. *SEC*, 440 U.S. 913 (1979); *SEC* v. *Universal Major Indus. Corp.*, 546 F.2d at 1048; *SEC* v. *Drexel Burnham Lambert, Inc.*, 837 F. Supp. 587, 611 (S.D.N.Y. 1993), *aff'd*, 16 F.3d 520 (2d Cir. 1994), *cert. denied*, 115 S. Ct. 724 (1995).

Accordingly, concluding that it is highly likely that future violations might occur, defendants First Jersey and Brennan are permanently enjoined from further violations of Securities Act § 17(a), Exchange Act § 10(b), and Rule 10b-5.[34]

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[33] (...continued)

> great big spotlights on them, and then we're going to put them on a witness stand under oath, and we're going to put them there under threat of going to jail if they continue to tell lies and misstatements about you and our firm.
>
> * * *
>
> It's going to be different because this time we're going to hold the people who have filed the complaint accountable, and they're not going to be able to run away and hide just because they move from the SEC. Undoubtedly, they won't be working for the SEC in the 1990's when this is ultimately resolved, but the spotlight will follow them wherever they go in the form of very strong, very, very meaningful litigation, lawsuits that will hold them accountable in financial terms and in every other way through a proper system of the court processes.

[34] First Jersey's belated withdrawal from Broker-Dealer Registration after closing arguments in this case is, viewed against the extensive and continuing history of violations here, ineffective to bar injunctive relief against it, *S.E.C.* v. *Bausch & Lomb, Inc.*, 565 F.2d 8, 18-19 (2d Cir. 1977), where there is "positive proof of a reasonable likelihood that past wrongdoing will return in some guise." While the sale of branches in 1987 perhaps only left First Jersey with *some* business, its principals, however, continued to operate violatively under other aegises elsewhere. Brennan and First Jersey remain, and Brennan and his associates in relationships forged at First Jersey continue to conduct themselves as before, as the Site-Based Media transaction in 1991, detailed *supra* shows. The "positive proof" envisaged by *Bausch & Lomb* exists here, and I so find. *Id.* at 18.

Disgorgement

Disgorgement is an appropriate form of ancillary relief granted in an SEC enforcement action. *See, e.g., SEC* v. *First City Fin. Corp.*, 890 F.2d 1215 (D.C. Cir. 1989); *SEC* v. *Tome*, 833 F.2d 1086 (2d Cir. 1987), *cert. denied sub nom., Lombardfin* v. *S.E.C.*, 486 U.S. 1014 (1988); *SEC* v. *Blavin*, 760 F.2d 706 (6th Cir. 1985); *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); *SEC* v. *Shapiro*, 494 F.2d 1301, 1309 (2d Cir. 1974); *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1972); *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971); *SEC* v. *Drexel Burnham Lambert Inc.*, 837 F. Supp. at 611.

"Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." *First City*, 890 F.2d at 1230. *See also Blavin*, 760 F.2d at 712-13; *Tome*, 833 F.2d at 1096; *SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *Chris-Craft Indus., Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 390-91 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); *Manor Nursing Centers*, 458 F.2d at 1104 ("The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable"); *Texas Gulf Sulphur Co.*, 446 F.2d at 1308 ("It would severely defeat the purposes of the [Exchange] Act if a violator of Rule 10b-5 were allowed to retain the profits from his violation"); *SEC* v. *Drexel Burnham Lambert Inc.*, 837 F. Supp. at 611-12.

The amount of disgorgement ordered "need only be a reasonable approximation of profits causally connected to the violation." The wrongdoer, who has created the uncertainty by his violation, bears the risk of uncertainty. *First City*, 890 F.2d at 1232 (citing *SEC* v. *MacDonald*, 699 F.2d 47, 55 (1st Cir. 1983) (*en banc*)); *Elkind* v. *Liggett & Myers, Inc.*, 635 F.2d 156, 171 (2d Cir. 1980); *Bigelow* v. *RKO Radio Pictures, Inc.*, 327 U.S. 251, 265 (1946) ("the most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created"). "The SEC need only offer a prima facie reasonable approximation; . . . and the risk of uncertainty should fall on the wrongdoer." *SEC* v. *Drexel*

Burnham Lambert Inc., 837 F. Supp. at 612 (quoting *SEC* v. *Bilzerian*, 814 F. Supp. 116, 121-22 (D.D.C. 1993), *aff'd*, 29 F.3d 689 (D.C. Cir. 1994)). This showing has been made here. The Commission has put before me such a reasonable approximation of defendants' profits in this case, and I reject the defendants' substitute methodologies in minimization. Those profits are:

Security		Profit
QT&T INC.	$	581,659
QUASAR		6,302,659
RAMPART		2,110,617
SEQUENTIAL		12,111,384
SOVEREIGN		5,172,292
TRANS NET		1,009,488
TOTAL	$	27,288,099

Accordingly, I order disgorgement which, after making a $5,000,000 adjustment discussed below,[35] is in the amount of $22,288,099 together with $49,251,521 prejudgment interest as of December 31, 1994, to be updated to the date of the final judgment to be submitted herein. This disgorgement appropriately flows from the basic fact that the defendants, having engaged in a deliberate scheme to buy securities from their customers and then, within days and without disclosure, to resell those securities or components thereof to many, many thousands of other unsuspecting customers at grossly excessive prices, should be required to surrender their *entire* gross profits from that conduct, including that below the 10% allowable markup.

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[35] The settlement in *In re First Jersey Securities, Inc. Securities Litigation*, M.D.L. No. 681, Class Action 85 Civ. 6059 provided for a $5,000,000 payment to a subclass involving members who had had transactions in QT&T, Rampart and Sovereign. The $5 million was paid in January 1987 and is accordingly deducted from the gross disgorgement here, and in the computation of prejudgment interest hereafter, no interest is assessed on that $5 million after December 31, 1986. That interest would have been $5,516,764, (*see* fn. 36 *infra*) from January 1, 1987 through December 31, 1994.

Defendants First Jersey and Brennan are jointly and severally liable for the said disgorgement, the proof showing that they both violated the securities laws together as primary violators. *See SEC* v. *Great Lakes Equities Co.*, 775 F. Supp. 211, 213-14 (E.D. Mich. 1991), *aff'd mem.*, 12 F.3d 214 (6th Cir. 1993); *SEC* v. *Micro-Therapeutics, Inc.*, Fed.Sec.L.Rep. (CCH) ¶ 99,086 (S.D.N.Y. Feb. 4, 1983); *SEC* v. *R.J. Allen & Associates, Inc.*, 386 F. Supp. 866, 880-81 (S.D. Fla. 1974). I observe that the same result would obtain if defendant Brennan's liability were measured under § 20(a) of the Exchange Act, which explicitly provides that a controlling person who fails to establish his "good faith" defense "shall also be liable jointly and severally with and to the same extent as [the] controlled person"—in this case, First Jersey. Defendants' disgorgement liability is not divisible, and it is ordered in the amount of $22,288,099.

Prejudgment Interest

An award of prejudgment interest is compelled here.[36] First Jersey's and Brennan's scienter has been fully proven as to the issues before me, and confirmed by Brennan's extensive conduct subsequent to the sale of First Jersey assets to Sherwood including the Hibbard Brown transaction in 1991. None of this would in all probability have been achievable by him without the income produced by the illegal markups and what those sums enabled him and First Jersey to further obtain,[37] and it would thus not serve justice to merely require disgorgement of $22 million and yet leave First Jersey and Brennan with its substantial—indeed comparatively enormous—fruits which, had the $22 million been put out at interest would have been some $49 million more. *Norte & Co.* v. *Huffines*, 416 F.2d 1189 (2d Cir. 1969).

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[36] Prejudgment interest is calculated through December 31, 1994, and is based on the standard rates (based on IRS underpayment of taxes rates) used by the Commission. *See, e.g., SEC* v. *Drexel Burnham Lambert Inc.*, 837 F. Supp. at 612 n.8.

[37] I note the over $25 million profit Brennan obtained through Austin Bernet from the Site Based Media transaction alone.

First Jersey and Brennan contend that prejudgment interest should not be awarded because—they claim—the SEC delayed the trial of this 1985-filed action to 1994. This action was assigned to me from the outset and I had neither awareness, nor did defendants make me aware of any such conduct by the SEC. I have also reviewed the docket sheets and find there no evidence to support this. Extensive discovery, including the obtaining and analysis of First Jersey's trading records and commission statements and countless depositions, was undertaken by both sides, with, I sensed, more than a pinch of acrimony. And, to the contrary of First Jersey's contention, as of early 1993, First Jersey was about to embark on a new round of discovery, having just obtained an order from the assigned Magistrate Judge to issue subpoenas duces tecum, (with presumably depositions to follow) to 142 broker-dealers for their trading records.[38] I reject any contention that the SEC delayed this case, and so should be barred from an award of prejudgment interest imposed on the disgorgement of the illegal markups.

Accordingly, prejudgment interest to December 31, 1994 is awarded as follows (to be brought up-to-date in the final judgment to be submitted hereafter):

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[38] I vacated this order in May 1993 and set the case for trial, which commenced, after a substantial flurry of motions by all parties, on June 1, 1994.

Prejudgment interest:

QT&T INC.	$ 899,113
QUASAR	14,289,784
RAMPART	4,874,881
SEQUENTIAL	20,841,684
SOVEREIGN	11,946,416
TRANS NET	1,916,407
TOTAL	$ 54,768,285
Adjustment per fn. 35	$ 5,516,764
ADJUSTED TOTAL	$ 49,251,521

The Appointment of a Special Agent

Finally, with defendants' violations with respect to Sovereign, Rampart, Quasar, TransNet, Sequential, and QT&T, spanning a period of more than two years, and viewing those violations against the background of defendants' sales and business practices, I am thoroughly convinced under any standard that the particular violations proved at trial are in all probability only the tip of the iceberg. Under the law, "[o]nce the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy." *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d at 1103; *see also SEC* v. *Posner*, 16 F.3d 520, 521 (2d Cir. 1994). Accordingly, I conclude that under the Court's general equitable powers, a special agent should be appointed to examine the records of defendant First Jersey Securities for the period from November 1, 1982 through January 31, 1987, for the purpose of determining whether there exists excessive markups and/or markdowns charged to FJS customers, beyond those proved at trial. Should any such excessive markups or markdowns be determined, the special agent shall recommend to the Court that defendants disgorge and pay over, as the Court may direct, all illegally-obtained profits.

Finally, to the extent not already determined adversely to them, defendants' remaining affirmative defenses are dismissed on the merits. I observe that laches, statutes of limitations, estoppel and waiver are not available against the SEC in enforcement actions. *SEC* v. *Willis*, 777 F. Supp. 1165, 1174-75 (S.D.N.Y. 1991); *see also SEC* v. *Culpepper*, 270 F.2d 241, 248 (2d Cir. 1959).

In sum, judgment is awarded to the plaintiff Securities and Exchange Commission and against First Jersey and Brennan jointly and severally directing disgorgement and prejudgment interest thereon, in the sum of $71,539,620 together with updated interest. A permanent injunction is granted as is the appointment of a special agent in all respects as set forth above, together with costs and disbursements to be taxed by the Clerk. The foregoing constitute my findings of fact[29] and conclusions of law, and are so ordered.

Submit formal judgment in accordance with the foregoing.

Date: New York, New York
June 19, 1995

s/Richard Owen
United States District Judge

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[29] I have also, consistent with a District Court's obligation under *Apx Oil Co.* v. *Vanguard Oil & Service Co. Inc.*, 760 F.2d 417, 421-22 (2d Cir. 1985), contemporaneously signed certain detailed findings of fact submitted by the plaintiff, having found them clearly proven.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

FIRST JERSEY SECURITIES, INC.
and ROBERT E. BRENNAN,

Defendants.

85 Civ. 8585 (RO).

THE COURT'S DETAILED FINDINGS OF FACT

A. Defendant First Jersey's Retail Securities Activities Through January 31, 1987

1. Since October 27, 1974, First Jersey Securities, Inc. ("First Jersey") has been a broker-dealer registered with the Commission pursuant to Section 15 of the Securities Exchange Act of 1934 ("Exchange Act"). (Defendants' Revised Responses to Plaintiff's Revised Request for Admissions ("Def. Adm. Resp."), ¶ 1, Tr.1908.)

2. From November 1, 1982 through January 31, 1987, First Jersey's organization included six major departments: Research, Compliance, Sales, Operations, Administration and Trading. (Def. Adm. Resp., ¶ 10, Tr. 1911.) At all times between November 1, 1982 and January 31, 1987, it was First Jersey's regular practice to mail confirmations, statements, checks and securities to its customers through its main office in New York City; branch offices did not perform such operating functions for

the firm. (Def. Adm. Resp., ¶ 9, Tr. 1910.) All markups on First Jersey principal sales of securities were calculated in the trading department located at the firm's home office. (Eyerman TT 2739.)[1]

3. From 1984 through January 1987, First Jersey operated approximately 32 retail branch offices. (Def. Adm. Resp., ¶ 2, Tr. 1909.) At its height during this period, First Jersey operated approximately 36 retail offices throughout the United States. (Brennan TT 1311.)

4. At all times between 1982 and January 1987, First Jersey specialized in the underwriting, trading and distribution of low-priced securities. (*See, e.g.*, Brennan TT 1326; Dwyer TT 94-95, 162; PX 88 [Doyle 12/15/88] at 10;[2] PX 90 [Ingles 08/09/89] at 245; PX 93 [Nooney 11/29/89] at 8-9; PX 99 [Thyer 11/10/88] at 26-27; PX 100 [Ware 02/22/89] at 160; DX 151 Bates #'s 014891-92, items 1-13, 17, 31-33, 38-39.)

5. Effective on January 31, 1987, First Jersey sold all but three of its retail offices to Sherwood Capital Group, Inc., for a total consideration of $20,000,000, to be paid as follows: $10,000,000 for assets; $5,000,000 to be paid to First Jersey for an agreement not to compete through January 30, 1992; and $5,000,000 to be paid to defendant Robert E. Brennan for an agreement not to compete through January 30, 1992. (Asset Purchase Agreement Between First Jersey and the Sherwood Group, PX 175 at 4 & Ex. E.)[3]

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[1] References to trial testimony in this case are cited with the witness's name, followed by "TT" and the trial transcript page.

[2] References to depositions in evidence are cited with plaintiff's (PX __) or defendants' (DX __) exhibit number, the deponent's last name, the deposition date and page number. For example: PX 88 [Doyle *date*] at ___.

[3] Effective on October 8, 1987, First Jersey sold its three remaining retail offices to F.N. Wolf & Co. for a total consideration of $1,000,000, broken down as $300,000 for assets and $700,000 to be paid to First Jersey for an agreement not to compete with the offices sold through October 8, 1990. (Agreement for Purchase of Certain Assets Between First Jersey and F.N. Wolf & Co., PX 176

(continued...)

6. At its height in 1986, First Jersey employed approximately 1,200 securities salesmen or "registered representatives." (Brennan TT 1311.)[4]

7. In recruiting new registered representatives, First Jersey targeted individuals who had no prior experience in the securities business. (Dwyer TT 77-78; PX 88 [Doyle 12/15/88] at 6-7; PX 95 [Ricciardello 10/12/89] at 25-26; PX 100 [Ware 02/22/89] at 9-14; PX 99 [Thyer 11/10/88] at 16; PX 93 [Nooney 11/29/88] at 10; PX 98 [Strong 10/19/88] at 10-11; Alsfeld TT 2656.)[5]

8. As of October 1986, First Jersey had a retail customer base of more than 500,000 accounts. (Brennan TT 1311-1312.)

9. First Jersey's retail selling capabilities enabled it to realize revenues of as much as $95,600,000 per year. Eighty to ninety percent of those revenues were received from principal transactions and underwriting income. Specifically, for the following fiscal years ended November 30, First Jersey's

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[3] (...continued)
at 2, 4.)

[4] Plaintiff called twelve former First Jersey salesmen as witnesses: Michael Dwyer testified at trial; five [Jeffrey Ingles, John Nooney, Donald Strong, Frederick Thyer and Claude Ware] testified via videotape depositions (PXs 90A, 93A, 98A, 99A and 100A respectively); and six [Timothy Cusick, Gerard Doyle, Robert Holly, Christopher Melton, Kenneth Stahlin and Fred Ricciardello] testified through transcribed depositions (PXs 87-89, 91, 97 and 95 respectively).

Defendants called twenty-two former First Jersey managers and salesmen: Leonard Alsfeld, John Csenge, Richard Egan, Havard Lee, William Maddox and William Sanders testified at trial. The remaining sixteen testified through transcribed depositions (DXs 616-631).

[5] Before acting as First Jersey salesmen, new recruits were required to take and pass the NASD's Series 7 examination. (Dwyer TT 150.)

They could not act as registered representatives without NASD certification. (Dwyer TT 150, 313-14; PX 90 [Ingles 03/15/89] at 6, 12-14; PX 87 [Cusick 12/15/88] at 3; PX 98 [Strong 03/16/89] at 288-289; PX 100 [Ware 02/22/89] at 141-143.)

commissions from agency transactions, revenues from transactions in which the firm acted as principal, underwriting income, interest and other income, and total revenues were as follows:

1982		
Commission Income	$	829,776
Revenues from Principal Transactions		44,009,372
Underwriting Income		2,328,713
Interest and Other Income		1,247,717
Total Revenues	$	48,415,578
1983		
Commission Income	$	2,240,119
Revenues from Principal Transactions		62,371,753
Underwriting Income		16,168,495
Interest and Other Income		4,478,104
Total Revenue	$	85,258,471
1984		
Commission Income	$	2,029,245
Revenues from Principal Transactions		76,990,788
Underwriting Income		8,406,261
Interest and Other Income		5,567,271
Total Revenue	$	92,993,555
1985		
Commission Income	$	3,097,676
Revenues from Principal Transactions		71,782,469
Underwriting Income		11,118,500
Interest and Other Income		9,661,770
Total Revenue	$	95,660,415
1986		
Commission Income	$	4,667,395
Revenues from Principal Transactions		70,684,542
Underwriting Income		7,529,172
Interest and Other Income		9,198,428
Total Revenue	$	92,079,537

(First Jersey Securities, Inc. Form X-17A-5 Filings for 1982, 1983, 1984, 1985, and 1986, PXs 35-39.)

10. For the month of December, 1986, First Jersey's revenues were as follows:

Commission Income	$ 271,378
Gains on Firm Securities Trading Accounts	6,034,511
Underwriting Income	99,569
Revenue from Sale of Investment Company Shares	466,500
Other Income	144,436
Total Revenue	$ 7,016,394

(First Jersey Focus Reports, Part II, for Periods Ended November 28, 1986 and December 31, 1986, PXs 111-112.)

11. For the quarter ended March 31, 1987, First Jersey's revenues were as follows:

Commission Income	$ 214,105
Gains on Firm Securities Trading Accounts	14,638,190
Underwriting Income	241,650
Revenue from Sale of Investment Company Shares	568,500
Other Income	421,337
Total Revenue	$16,083,782

(First Jersey Focus Report, Part II, for Quarter Ended March 31, 1987, PX 113.)

12. The primary duties and responsibilities of First Jersey salesmen were to prospect for new clients, find potential investors, and sell customers low-priced securities which First Jersey sold as principal. (Dwyer TT 86, 126; PX 87 [Cusick 12/15/88] at 21-23; PX 93 [Nooney 11/29/88] at 15-19; PX 95 [Ricciardello 10/12/89] at 54-59; PX 98 [Strong 10/19/88] at 15; PX 99 [Thyer 11/10/88] at 30-31; PX 88 [Doyle 12/15/88] at 10, 12; PX 100 [Ware 02/22/89] at 89.)

13. The monthly activities of First Jersey salesmen were generally divided into three categories: prospecting for

customers, "qualifying" them, and recommending low-priced securities. (Dwyer TT 90-92, 87; PX 95 [Ricciardello 10/12/89] at 52-53; PX 88 [Doyle 12/15/88] at 14-15; PX 90 [Ingles 03/15/89] at 23-25, 176; PX 93 [Nooney 11/29/88] at 15-19; PX 100 [Ware 02/22/89] at 31-35; PX 99 [Thyer 11/10/88] at 25-26; PX 98 [Strong 10/19/88] at 23-24.)

14. These monthly activities generally conformed to a First Jersey "pay period," which typically ended on the third Friday of a calendar month. (Dwyer TT 87; PX 88 [Doyle 12/15/88] at 10, 14; PX 99 [Thyer 11/10/88] at 22; *see also* PXs 114-131, 144-158, 161-169.) With the exception of underwritings -- which were sold at various times during a pay period -- the monthly cycle of prospecting, "qualifying" and recommending low-priced securities did not vary significantly during the period 1982 through at least early 1986. (Dwyer TT 98; PX 93 [Nooney 11/29/88] at 30-31; PX 100 [Ware 02/22/89] at 183-184.)

15. The timing of these activities was determined by branch office managers. The process of recontacting prospects was known in branch offices variously as "touching base" or "requalifying." (Dwyer TT 91; PX 99 [Thyer 11/10/88] at 30-31; PX 95 [Ricciardello 10/12/89] at 55-56; PX 90 [Ingles 03/15/89] at 24-25; PX 93 [Nooney 11/29/88] at 15-16.) Branch office managers received instructions on when to "requalify" and when to recommend from First Jersey's home office. (Dwyer TT 211; PX 88 [Doyle 12/15/88] at 14-15; PX 95 [Ricciardello 10/12/89] at 52-53; 57; 71-72, 174, 211; PX 99 [Thyer 11/10/88] at 38-39; PX 90 [Ingles 03/15/89] at 27-28; PX 93 [Nooney 11/29/88] at 30-32; PX 98 [Strong 04/25/89] at 461-462; PX 100 [Ware 02/22/89] at 34- 35.) Generally, under the direction of their office managers, branch office salesmen performed the tasks of prospecting, "requalifying" and recommending securities to their customers as a group. (Dwyer TT 92-93; PX 90 [Ingles 03/15/89] at 27-28; PX 93 [Nooney 11/29/88 at 16-17; PX 99 [Thyer 11/10/88] at 32, 98; PX 100 [Ware 02/22/89] at 209.)

16. At the direction of branch office managers, First Jersey salesmen were expected to "prospect" for customers. (Dwyer TT 86, 90-91.) In prospecting for new customers, First Jersey relied heavily upon "cold calling" of individuals selected

from general directories including the local telephone directory. (Dwyer TT 86; PX 87, Cusick [12/15/88] at 21; PX 99, Thyer [11/10/88] at 25; PX 100, Ware [02/22/89] at 14-15; PX 90 [Ingles 03/15/89] at 25-26.)

17. The purpose of prospecting in First Jersey branch offices was to identify possible customers for the next First Jersey recommendation. (Dwyer TT 168; PX 95 [Ricciardello 10/12/89] at 25; PX 98 [Strong 10/19/88] at 15-16; PX 88 [Doyle 12/15/88] at 11-12; PX 90 [Ingles 03/15/89] at 24, [Ingles 08/09/89] at 242; PX 93 [Nooney 11/29/88] at 12-13; PX 99 [Thyer 11/10/88] at 25-26.)

18. Although First Jersey recommendations were usually low-priced securities which the firm sold as principal, salesmen were instructed to make only a general inquiry as to whether a customer was willing to accept "risk."[9] (Dwyer TT 162-70, 178-79; PX 88 [Doyle 12/15/88] at 12; PX 99 [Thyer 11/10/88] at 34, 36; PX 90 [Ingles 03/15/89] at 31-33, [Ingles 08/09/89] at 245.)

19. If a prospect agreed to consider a future recommendation, salesmen were instructed to record his or her name, address and other identifying information. (Dwyer TT 281-282; PX 88 [Doyle 12/15/88] at 12-13; PX 95 [Ricciardello 10/12/89] at 54; PX 99 [Thyer 11/10/88] at 28.) First Jersey did not require salesmen to record a customer's income or investment objectives in writing until after this action was filed in October 1985. (Dwyer TT 165, 185; PX 90 [Ingles 03/15/89] at 33; PX 99 [Thyer 11/10/88] at 130; *compare*: PX 142 with PX 250.)

20. Each pay period—after prospecting and prior to a recommendation—it was the regular practice of First Jersey branch office managers to inform salesmen that First Jersey's research department would recommend an investment in the near future. Branch managers instructed salesmen to re-contact prospects to

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[9] With respect to disclosure of the risks inherent in the low-priced securities it sold, First Jersey merely provided copies of its "Approach and Philosophy" to salesmen for use in customer calls. (DX 3; *see e.g.*, PX 90 [Ingles 03/15/89] at 30-31; PX 93 [Nooney 11/29/88] at 21-22.)

determine how much money they had available to invest. (Dwyer TT 91-93, 170; PX 88 [Doyle 12/15/88] at 10-13; PX 90 [Ingles 03/15/89] at 29-30; PX 87 [Cusick 12/15/88] at 23-24; PX 99 [Thyer 11/10/88] at 30-31; PX 93 [Nooney 11/29/88] at 15-16; PX 98 [Strong 04/25/89] at 441-442, 462.)

21. At that time, salesmen were not told the name of the company whose securities would be recommended and had no specific information regarding the upcoming recommendation. (Dwyer TT 91-93, 170; PX 88 [Doyle 12/15/88] at 10-13; PX 90 [Ingles 03/15/89] at 29-31; PX 98 [Strong 10/19/88] at 36, 55-56; PX 87 [Cusick 12/15/88] at 23-24; PX 99 [Thyer 11/10/88] at 30-31; PX 93 [Nooney 11/29/88] at 15-16.)

22. The process of "requalifying" or "touching base" was not related to any kind of analysis of a particular customer's needs, but rather was a method for determining how much customer money was available for an upcoming First Jersey recommendation. (Dwyer TT 91, 178; PX 88 [Doyle 12/15/88] at 12; PX 93 [Nooney 11/29/88] at 15-17, 21; PX 98 [Strong 04/25/89] at 462-63; PX 99 [Thyer 11/10/89] at 130; PX 90 [Ingles 03/15/89] at 183-84.)

23. After "requalifying" or "touching base," it was the regular practice of First Jersey for its New York City or Red Bank, New Jersey office to inform branch managers of the securities to be recommended that month to retail customers. (Brennan TT 1337, 1339-1340, 1346; PX 87 [Cusick 12/15/88] at 21-27; PX 88 [Doyle 12/15/88] at 10, 15-19, 23-24, 52-53; PX 98 [Strong 04/25/89] at 471; PX 100 [Ware 07/11/89] at 257-258, [Ware 02/22/89] at 35-36; PX 90 [Ingles 03/15/89] at 34; PX 93 [Nooney 11/29/88] at 25-26; PX 99 [Thyer] 11/10/88 at 38-39.)

24. Generally during the last week of a pay period, at the direction of the home office, branch managers held "recommendation meetings," informing salesmen of the particular branch office's recommendation for that pay period. These recommendations were for OTC securities which First Jersey sold to customers as principal. (Dwyer TT 87-88; PX 87 [Cusick 12/15/88] at 21; PX 88 [Doyle 12/15/88] at 17-18; PX 100 [Ware

02/22/89] at 19-20; PX 98 [Strong 10/19/88 at 60-61; 03/16/89] at 169-70; PX 99 [Thyer 11/10/88] at 37-40.)

25. At recommendation meetings branch managers dictated a sales presentation or "script" on how to sell the recommended security. (Dwyer TT 87; PX 88 [Doyle 12/15/88] at 10-11; PX 93 [Nooney 11/29/88] at 27, 40, 44; PX 100 [Ware 02/22/89] at 18; PX 90 [Ingles 03/15/89] at 132-33); Salesmen were required to record these presentations and use them in contacting clients. (*Ibid.*; PX 88 [Doyle 12/15/88] at 21-22; PX 95 [Ricciardello 10/12/89] at 58-59.) Salesmen were also given written materials which sometimes included First Jersey research reports, annual reports and newspaper articles concerning the recommended company. Negative factors, such as risks inherent in the recommended security, were generally not discussed. (Dwyer TT 111, 120, 273, 316-317; PX 90 [Ingles 03/15/89] at 43, [Ingles 08/09/89] at 299; PX 93 [Nooney 11/29/88] at 41-41; PX 98 [Strong 09/14/89] at 346; PX 99 [Thyer 11/29/88] at 46.)

26. Salesmen were also advised of the commission they would make on the sale of a new recommendation at the recommendation meeting. (Dwyer TT 87; PX 88 [Doyle 12/15/88] at 27-28; PX 90 [Ingles 03/15/89] at 38, 261-63; PX 93 [Nooney 11/29/88] at 40-41.) Commissions for First Jersey recommendations ranged from three percent for underwritings to as high as ten percent for principal transactions. (Dwyer TT 88; PX 90 [Ingles 03/15/89] at 21-22; PX 93 [Nooney 11/29/88] at 15; PX 99 [Thyer 11/10/88] at 23; PX 100 [Ware 02/22/89] at 15.) In addition, First Jersey office managers received a 50% "override commission" on all sales, which at times were split with other senior salesmen. (Csenge TT 3243-3244; Lee TT 2492-2493; PX 123A, Bates # 0770.)

27. After a branch office recommendation meeting, First Jersey salesmen were expected to sell the recommended security to their customers. (Dwyer TT 211; PX 88 [Doyle 12/15/88] at 23-25; PX 93 [Nooney 11/29/88] at 25-27; PX 100 [Ware 02/22/89] at 37.) All salesmen in each branch office typically recommended the same security at the end of a pay period. (Dwyer TT 87, 94; PX 88 [Doyle 12/15/88] at 23-24; *see also* PXs 114-131, 144-158, 161-169.)

28. It was the regular practice of First Jersey to instruct First Jersey salesmen in methods designed to make customers' investment decisions conform with the firm's recommendations. (PX 88, Doyle [12/15/88] at 23-24, [03/06/90] at 103-04, [03/07/90] at 55-58; PX 90, Ingles [03/15/89] at 23-27; PX 91, Melton [12/15/88] at 38; PX 100, Ware [02/22/89] at 36-37, 154-55.)

29. First Jersey salesmen were prohibited from discussing branch office recommendations with salesmen from other First Jersey branch offices. (Dwyer TT 126-127; PX 87, Cusick [12/15/88] at 31; PX 88, Doyle [12/15/88] at 34; PX 91, Melton [12/15/88] at 29; PX 93, Nooney [11/29/88] at 42-43; PX 100, Ware [02/22/89] at 28-29; PX 98, Strong [04/25/89] at 461-62; PX 99 [Thyer 11/10/88] at 74.)

30. First Jersey salesmen were discouraged from conducting independent research on First Jersey recommended securities, and First Jersey branch offices were organized so that requests to the New York City office for information concerning such securities would be channeled through branch office managers. (Dwyer TT 96-97; PX 87 [Cusick 12/15/88] at 29; PX 88 [Doyle 03/07/90] at 47; PX 90 [Ingles 03/15/89] at 37-38; PX 95 [Ricciardello 10/12/89] at 61, [Ricciardello 10/13/89] at 282-83; PX 99 [Thyer 11/10/88] at 47, 51; PX 98 [Strong 10/19/88] at 35-36; PX 100 [Ware 02/22/89] at 18-19.)

31. First Jersey salesmen were discouraged from recommending that customers effect securities transactions different from their particular branch office's monthly recommendations (Dwyer TT 87-88, 105, 229-231; PX 87, Cusick [12/15/88] at 33-34; PX 88, Doyle [03/06/90] at 100-101, 102-103; PX 89, Holly [06/09/86] at 44; PX 91, Melton [12/15/88] at 22-23; PX 95, Ricciardello [10/13/89] at 259-261, 264; PX 90 [Ingles 03/15/89] at 44; PX 100 [Ware 02/22/89] at 184-185), and on occasion were disciplined for doing so (Dwyer TT 229-30; PX 98 [Strong 10/19/88] at 73-75; PX 87 [Cusick 12/15/88] at 32-34; PX 100 [Ware 02/22/89] at 219; PX 93 [Nooney 11/29/88] at 23, 33- 34).

32. On those occasions where a branch office recommended a security that had been a component of a recent First Jersey unit underwriting, salesmen in the branch office were not advised of the underwriting, provided with the prospectus, or advised of the risk factor disclosures in the prospectus. (Dwyer TT 107-08, 118-20; PX 90 [Ingles 03/15/89] at 201-202; PX 98 [Strong 09/14/89] at 377; PX 100 [Ware 07/12/89] at 405.)[7]

33. In addition to selling OTC securities to customers as principal, First Jersey had the regular practice of causing various branch offices within the First Jersey system to recommend that customers purchase securities underwritten by the firm. (Brennan TT 1354; Dwyer TT 113-115; PX 87, Cusick [12/15/88] at 21-22, 37-38; PX 95, Ricciardello [02/27/90] at 347-349; PX 98, Strong [10/19/88] at 81-83; PX 99 [Thyer 11/10/88] at 22-23.)

34. Between November 1, 1982 and August 12, 1986 First Jersey acted as the sole underwriter for at least thirty-one unit underwritings priced from $.75 to $3.75, which units could be split at any time up to a date certain at First Jersey's sole discretion. (Prospectuses, PXs 1-5, 7, 297-309, 311-322.)

35. It was the regular practice of First Jersey to solicit certain customers who purchased securities in First Jersey underwritings to sell those securities back to First Jersey at a "profit," which "profit" was determined at the sole discretion of defendants rather than by the marketplace.[8] (Dwyer TT 123-125; PX 87, Cusick [12/15/88] at 37-38; PX 94, Parker [03/17/92] at 120-150; PX 95, Ricciardello [10/12/89] at 68-71; PX 98, Strong

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[7] Offering prospectuses contain information relevant to the securities of the issuer for up to one year after the offering date. (Alsfeld TT 2644-2645; Egan TT 2301-2302; Lee TT 2496-2497.)

[8] For example, when questioned by the Court as to how a $3.50 price was established for First Jersey's repurchases of Sovereign Chemical units in November 1982 in light of the fact that Sovereign units were not traded by any broker/dealer other than First Jersey, Brennan admitted that the repurchase price was set by First Jersey's own trading department. (Brennan TT 1378; *see* generally Brennan TT 1372-78.)

[10/19/88] at 82-83 and [03/16/89] at 109-110; PX 93 [Nooney 11/29/88] at 37-38.)

36. Salesmen who recommended that customers take "profits" from underwritings were not told of First Jersey's intent to split the repurchased units into their component securities. (Dwyer TT 116-17, 124; PX 98 [Strong 03/16/89] at 107, 142; Csenge TT 3248, 3253; Sanders TT 3318.)

37. It was the regular practice of First Jersey to cause various branch offices to recommend that customers selling securities reinvest the proceeds of such sales in stocks in which First Jersey made a market, rather than take profits. (Brennan TT 1488; Dwyer TT 115-116, 122-125, 141-142; PX 88 [Doyle 12/15/88] at 24-25; PX 91 [Melton 12/15/88] at 20-22; PX 93 [Nooney 11/29/88] at 51-52; PX 99 [Thyer 11/10/88] at 56-58, 60-64, 66-67; PX 98 [Strong 10/19/88] at 73-75; PX 94 [Parker 03/17/92] at 120-150; PX 96 [Sekol 05/07/92] at 152-154.)

38. First Jersey organized the compensation system for salesmen so that the last week in a pay period normally coincided with the recommendation of a security in which First Jersey made a market, and set commission rates to motivate salesmen to sell such securities to their customers. (Brennan TT 1484-1485; Dwyer TT 87-94, 98, 213; PX 88, Doyle [12/15/88] at 14-15; PX 100, Ware [02/22/89] at 18, [04/03/90] at 534.) Salesmen did not receive commissions when customers sold a security which First Jersey purchased as principal. (Dwyer TT 213; PX 88 [Doyle 12/15/88] at 9; PX 90 [Ingles 03/15/89] at 22; PX 99 [Thyer 11/10/88] at 21-22.)

39. Commissions earned on First Jersey recommendations were significantly higher than commissions salesmen could earn through agency transactions. (Dwyer TT 90; PX 90 [Ingles 03/15/89] at 23; PX 93 [Nooney 11/29/88] at 22-23; PX 99 [Thyer 11/10/88] at 23-34.) Because the First Jersey sales cycle of prospecting, qualifying and recommending left salesmen largely without commissions until the end of a pay period, First Jersey salesmen were motivated to sell the firm's recommendations at the times they were made. (PX 88 [Doyle 12/15/88] at 17-18; PX 100 [Ware 02/22/89] at 35-36; PX 99 [Thyer 11/10/88] at 39.)

40. First Jersey's home office generated monthly, and sent to all First Jersey salesmen, documents known as "commission statements" which recorded *all* customer purchases and sales of securities (including "special products") for a particular salesman in a branch office. (Dwyer TT 100; Lee TT 2491-92.)[2/]

41. The commission statements of 127 former First Jersey salesmen—variously representing First Jersey customer purchases and sales in eight First Jersey branch offices between June 22, 1981 and January 23, 1987—were offered by plaintiff and admitted in evidence. Defendants offered no commission statements. The following chart summarizes, by First Jersey branch office, those commission statements and the time periods they represent:

PX#	OFFICE	TIME[S] COVERED	SALESMAN
167	Boston	12/83 - 09/84	Various
169	" "	03/86 - 06/86	" "
			(total: 65)
123A	Creve Coeur	09/83 - 08/85	Various
124A	" "	09/85 - 01/87	" "
			(total: 44)
139	Atlanta	12/81 - 11/84	Ricciardello
158	" "	09/82 - 02/84	Thyer
162	" "	12/81 - 05/83	Jones
163	" "	12/81 - 03/83	Stephens
164	" "	05/82 - 12/82	Delong
121	Houston	02/82 - 03/83	Ingles
131	" "	12/82 - 02/84	Nooney
165	" "	11/82 - 03/84	Buggey
166	" "	11/82 - 11/83	Decker

[2/] The format of First Jersey commission statements is described at Dwyer TT 100-102 and Lee TT 2475. A "special product" or "investment product" in the context of this case was defined by First Jersey counsel as "a variety of mutual funds and unit trusts and bonds and things of that nature ..." (Tr. 246-47)

168	New Orleans	02/86 - 05/86	Various (total: 6)
006	Kansas Cty.	07/82 - 01/86	Dwyer
120	Darien	12/81 - 02/83	T. Dunn
161	Boston/St. Petersburg	06/81 - 01/87	Govoni

These commission statements confirm the general sales pattern at First Jersey: the vast majority of commission-generating transactions in the firm's retail offices were First Jersey principal sales effected at the end of a pay period. (*See generally* PXs 114-131, 144-158, 161-169.)

42. For example, commission statements for First Jersey's Creve Coeur branch office for the pay period ending November 22, 1983 reflect that 157 of a total of 163 customer transactions were effected in the last eight days of the pay period. (PX 123A, Bates # 's 0645-52; Lee TT 2483.) Moreover, all but 18 of the 163 transactions reflect customer sales of Transnet units or customer purchases of Lincoln Logs common stock or warrants (with First Jersey selling as principal). (*Ibid.*) Similarly, during the pay period ending June 26, 1984 Creve Coeur's commission statements reflect 516 customer transactions, of which 409 are customer purchases of Sequential Information Systems common stock (with first Jersey selling as principal) during the last seven days of the pay period. (PX 123A, Bates # 's 0770-91; Lee TT 2493.)

43. The other commission statements in evidence reflect the same general sales pattern of the vast majority of customer purchases effected for First Jersey principal sales at the end of a pay period. For example:

* Commission statements for 28 salesmen in the firm's Massachusetts office for the pay period ending June 26, 1984 reflect that the vast majority of customer purchases between June 20-26, 1984 were for Sequential Information Systems common stock (with First Jersey selling as

principal), generating most of the commissions earned by salesmen during that period. (PX 167, Bates #'s 0177-213.)

* Commission statements for five salesmen in the firm's Atlanta branch office for the pay period ending November 26, 1982 reflect customer buys in Rampart General common stock and customer sales of Sovereign Chemical units beginning November 18 and continuing to the end of the pay period to the near exclusion of any other customer trading activity.[10] (PXs 139, 158, 162-164.) These commission statements further confirm that customers selling Sovereign units also purchased Rampart common stock the same day. (See e.g., PX 158, p. 2.)[11]

* Commission statements for four salesmen in the firm's Houston branch office for the pay period ending February 18, 1983 reflect that between February 15-18 all but two customer transactions were buys of a security designated "URTS A" which First Jersey sold as principal. (PXs 121, 131, 165- 66.)

* Commission statements for six salesmen in the firm's New Orleans office for a three month period (late February-May 1986) near the end of First Jersey's retail sales operations further confirm this sales pattern at least through April

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[10] Although these defense witnesses did not have commission statements, their customer transaction sheets confirm that their customers purchased and sold the securities at issue here as described by plaintiff's witnesses from the same office. For example, PX 356 at Bates # 015122 shows a customer buying 1000 Sovereign Chemical units on "11/9/82 at $3," selling those units on "11/18/82 at $3½" for a "profit of $500" while buying 650 shares of Rampart General on "11/18/82 at $2 ½" as well as another security sold by First Jersey as principal. The same type of transactions [e.g. Sovereign unit buys/sells and Rampart buys] are recorded for different customers of the same salesmen on the same days in PX 356 at Bates #'s 015123, 015124, 015128, 015131, 015133, 015134, and 015138.

[11] A comparison of customer account numbers on PX 158 at p. 2 establishes that ten of thirteen customers selling Sovereign units purchased Rampart General common stock, thus generating commissions (column "P," PX 158) for the salesman.

1986. (PX 168) For the pay period ending April 18, 1986 the customers of all six salesmen purchased a security designated as "IMAT" and sold by First Jersey as principal to the near exclusion of other activity.[12] (*Ibid.*, Bates #'s 011086-93.)

1. Defendants' Evidence Regarding First Jersey's Sales Practices and Compliance Procedures

44. Defendants called four former First Jersey branch office managers and two former First Jersey salesmen as witnesses at trial regarding First Jersey's sales practices.

45. After First Jersey sold its retail offices to Sherwood Capital in 1987, each of defendants' salesmen witnesses had moved on to Sherwood and then, when Sherwood went out of business in 1988, to either Hibbard Brown & Co. or F.N. Wolf & Co. (Egan TT 2090-91; Lee TT 2335-2336; Alsfeld TT 2220-21; Csenge TT 3106-07; Maddox TT 3353-54; Sanders TT 3265-3268); in fact, William Maddox's supervisor at Hibbard Brown & Company is the same person who supervised him at First Jersey (Maddox TT 3400-01). Thus, each of them continued in the "penny stock" business.

a. *Havard Lee*. *Lee* was employed by First Jersey as a salesman and a manager from April 1979 through February 1987. (Lee TT 2336-37.) Lee worked in the firm's Red Bank, New Jersey, Shawnee Mission, Kansas and Creve Coeur, Missouri branch offices. (Lee TT 2337.) Lee was the office manager of First Jersey's Creve Coeur branch office from the Fall of 1983 until the office was sold in early 1987. (*Ibid.*) Lee conceded that as manager of the Creve Coeur office he never gave an office recommendation for a security other than First Jersey recommendations because he followed the recommendations of the firm's research department. (Lee TT 2454.) After initially refusing to produce First Jersey commission statements for the Creve Coeur office during discovery, Lee ultimately did so under this Court's Order. (Lee TT 2457; PXs 123A-124A.) The Creve

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[12] PX 168 reflects that 65 of 82 transactions were for purchases of "IMAT."

Coeur commission statements ultimately produced by Lee confirm the testimony of the Commission's salesmen witnesses that the vast majority of transactions effected by First Jersey's salesforce were in securities sold at the end of a pay period. (PXs 123A, 124A.) Lee conceded that where commission statements of various registered representatives reflect customer buys of securities sold by First Jersey beginning on or about the same day in all likelihood there was a recommendation meeting with respect to such security. (Lee TT 2496.) Lee further conceded that the commission structure of First Jersey was such that it was in the best economic interest of both managers (who received overrides) and salesmen to sell securities recommended by the firm. (Lee TT 2506-07.)

b. *Leonard Alsfeld.* Alsfeld was employed by First Jersey as a salesman and manager from August 1978 through February 1987. (Alsfeld TT 2521.) Alsfeld worked in First Jersey's Massachusetts office through sometime in 1981, and thereafter was the manager of the firm's Louisiana office. (Alsfeld TT 2521-22.) Alsfeld confirmed the testimony of the former salesmen called to testify by plaintiff in that: (1) he admitted First Jersey recommendations came from the firm's research department; (2) he assumed—and so advised registered representatives—that no research beyond that received from the firm's research department was necessary prior to selling First Jersey recommended securities; and (3) he held pre-recommendation meetings similar to "touch base" meetings. (Alsfeld TT 2645-46.) Alsfeld further affirmed that the highest commissions a salesman at First Jersey could earn were on sales of securities recommended by the firm, and that on occasion the commission rate on a First Jersey recommended security was as high as ten percent of the amount invested by the customer. (Alsfeld TT 2647-2648.) Although Alsfeld produced no commission statements for the Louisiana branch office for 1982-1985, he estimated that during the period 1981-1984, 75 percent of the dollar volume of securities business in the Louisiana office was for First Jersey recommended stocks. (Alsfeld TT 2657-58.) Counting his personal commissions and override commissions on the production of other salesmen, Alsfeld earned approximately $758,000 in 1984 and $897,000 in 1985 as the

manager of First Jersey's Louisiana office. (Alsfeld TT 2648-50, 2654; PX 251A-C.)[12/]

c. *John Csenge*. Csenge was employed by First Jersey as a salesman and manager from approximately April 1980 until February 1987. (Csenge TT 3107.) Csenge agreed that most of the money he earned at First Jersey came from commissions and override commissions, and that as time went by most of his compensation came from overrides on the commissions of salesmen under his direction. (Csenge TT 3233.) Csenge further conceded that the highest commissions salesmen earned at his branch office were on First Jersey recommendations. (Csenge TT 3244.) Although Csenge was confronted with PX 251B (later admitted into evidence) which showed his 1985 First Jersey earnings from commissions and overrides as $433,000, he would not confirm that figure even as an approximation. (Csenge TT 3244-46.) Csenge testified that the Saint Petersburg office sold Sequential Information Systems units in the June 1984 underwriting by First Jersey, that "some" customers sold their units back to First Jersey at a "profit," but testified that he knew nothing about First Jersey's intent to split Sequential units that same month. (Csenge TT 3247-48.)

d. *William Maddox*. Maddox was employed by First Jersey as a salesman in its Red Bank, New Jersey office from 1982 through February 1987. (Maddox TT 3354.) Maddox had only the vaguest recollections of recommendations relating to the

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[12/] In September 1990 the NASD found that Alsfeld, among others, had engaged in conduct that was "inconsistent with the high standards of commercial honor and just and equitable principles of trade" in connection with his supervisory duties at First Jersey during the period July 1982 through August 1986. (PX 78, p. 13, First-Third, Fifth-Tenth and Thirteenth-Fourteenth Causes of Complaint.) As a result of that proceeding—for which Alsfeld submitted an offer of settlement without admitting or denying the underlying allegations—Alsfeld was fined $50,000 and suspended* from any association with a member of the NASD. (PX 78, p.15; Alsfeld TT 2665.) First Jersey paid the $50,000 fine on Alsfeld's behalf. (*Ibid.*)

Further, Matthew Wochele, one of defendants' deposition witnesses (DX 628), was censured and fined $5,000 in connection with his conduct as the manager of First Jersey's Atlanta, Georgia branch office. (PXs 387-89; DX 628 [Wochele 05/12/93] at 936-38.)

securities in this matter in the Red Bank office. (*See e.g.*, Maddox TT 3367-69 [Rampart], 3371 [Transnet], 3375 [Quasar Microsystems and QT&T], 3381-83 [Sovereign Chemical], and 3387 [Sequential Information Systems].) Maddox did not produce any commission statements, which he admitted would give a record of all his customers' buys and sells of securities in a pay period. (Maddox TT 3408-09.) Without his commission statements Maddox estimated that between 75 and 90 percent of his customers' investment dollars were invested in OTC stocks. (Maddox TT 3388.) Maddox conceded that his work schedule as a salesman in First Jersey's Red Bank, New Jersey branch office was set by his supervisors throughout the five years he worked for the firm. (Maddox TT 3358-59, 3395.)

e. *William Sanders*. Sanders was employed as a salesman and manager by First Jersey in its Louisiana office from January 1984 through February 1987. (Sanders TT 3268-69.) Sanders admitted that he never made a securities recommendation at First Jersey that was not a firm recommendation. (Sanders TT 3345.) Sanders testified that his customers bought units in at least two underwritings at issue in this matter--Sequential Information Systems and QT&T. (Sanders TT 3297-3298, 3311-3312.) Sanders admitted that all the information he received concerning these underwritings, including increases in unit prices shortly after his customers purchased, came from Alsfeld. (Sanders TT 3302-3303.) Sanders further testified that "it was a very good time to ask (customers) for additional money if a new issue was up." (Sanders TT 3303.) Sanders admitted, however, that when he advised his customers of "profits" in unit underwritings he did not know of First Jersey's intention to split the units it repurchased into their component securities. (Sanders TT 3318.)[14]

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[14] Defendants submitted the depositions of sixteen former First Jersey managers and salesmen as a part of their case. (DXs 616631.) As is true with those defense witnesses who testified at trial, after First Jersey sold its retail offices to Sherwood Capital in 1987, these deponents generally moved on to Sherwood and then to either F.N. Wolf or Hibbard Brown & Company. (*See* e.g., DX 616 [Calkins 07/10/90] at 8-10; DX 617 [Carcato 05/04/89] at 3-5; DX 618 [Clem 04/04/91] at 101; DX 619 [Collier 04/17/90] at 6-7; DX 624 [Pieramozzi

(continued...)

47. At various times during the period 1982 through February 1987 First Jersey produced "training manuals." (DX 150 and 151.) However, not all registered representatives received "training manuals," and in some instances only excerpts from those documents were made available to new salesmen. (Dwyer TT 85, 288; PX 95 [Ricciardello 10/12/89] at 44; PX 87 [Cusick 12/15/88] at 15-16; PX 90 [Ingles 03/15/89] at 14-16, 20-21, 227-28, 233; PX 88 [Doyle 12/15/88] at 5-7.)

48. Generally, these "training manuals" did not contain information regarding low-priced securities of the kind typically offered by First Jersey. (*See, e.g.*, DX 151 Bates #'s 014891-93.) In fact Egan—who, together with Jack Dell, First Jersey's Director of Sales, developed a First Jersey "training manual" in about 1979-1980 (Egan TT 2103; *see* DX 150 and 151)—conceded that even though First Jersey's business emphasis was on the sale of low-priced securities as principal, including the underwriting of about 10 new unit offerings per year, the "training manual" gave no guidance on such things as appropriate holding periods for such securities, appropriate product mixes for clients, how to build "balanced portfolios" for clients, or how to read a prospectus. (Egan TT 2297-2305.) Further, Egan agreed that a First Jersey manager would have been in a much better position to assess

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[19] (...continued)
05/22/89] at 3-4.)

Not one of these sixteen deponents produced his own commission statements when deposed. However, commission statements of two of these deponents—Michael Dunn and Robert Taggart—are part of PXs 123A and 124A produced by Havard Lee by order of this Court. Those commission statements confirm the testimony of plaintiff's salesman witness with respect to the pattern of customer purchases at or near the end of a pay period as well as the percentage of customer investment dollars placed in First Jersey principal stocks. (*See* e.g., PX 123A at Bates #s 0649, 0772-79, 0791, 0965, 1038.)

Further, one of the deponents—William Calkins—was found by the NASD to have engaged in conduct "inconsistent with high standards of commercial honor and just and equitable principals of trade" in connection with his recommending and selling to customers certain securities during the period July 1982 through August 1986 while employed at First Jersey. Calkins consented to the imposition of a $5,000 fine and was censured as a result of his conduct. (PX 78.)

"suitability" of First Jersey recommendations to customers after November 1985, when the firm's new account cards required statements of a customer's financial objectives and financial capabilities. (Egan TT 2317-2320; compare DX 151 at Bates #'s 015016-18 with PX 250.)

49. Defendants also made frequent reference to documents known as "First Jersey Registered Representative Questionnaires," which First Jersey salesmen were obliged to fill out at least annually and sometimes more often. (*See, e.g.*, DXs 9, 12-13, 16 and 50.) These questionnaires purport to elicit factual information of use to First Jersey home office personnel in exercising their compliance functions. (*Ibid.*, cover page.) In fact, First Jersey salesmen viewed these questionnaires as conditions of their employment. (Dwyer TT 298, 312; PX 88 [Doyle 04/19/90] at 56-57, 61; PX 98 [Strong 04/19/90] at 7; PX 100 [Ware 07/12/89] at 422.)

50. As a matter of practice, these questionnaires were presented to salesmen in a group, and at times the "correct" responses were dictated to the group by the office manager. (Dwyer TT 265, 304-05; PX 98 [Strong 04/26/89] at 8-9.) Salesmen answered some questions knowing at the times their responses were given that their answers were incorrect. (Dwyer TT 269-75, 308; PX 88 [Doyle 12/15/88] at 50; PX 98 [Strong 04/25/89] at 493-94, [04/26/89] at 4-6; *see e.g*, DX 50, questions 23-25.) Other responses to questions were given as they were only because salesmen were ignorant of the true nature of First Jersey's retail sales operations. (Dwyer TT 272-75, 309-10; PX 90 [Ingles 08/09/89] at 283-284; *see, e.g.*, DX 50, questions 28, 29, 31A, 31B, 32 and 37.)

51. On their face the Registered Representative Questionnaires are self-serving. (DX 50.)

52. In addition to periodic Registered Representative Questionnaires, First Jersey salesmen were also required to sign a form letter to *Forbes* magazine in May 1984. (*See e.g.*, DX 10.) Signing this letter also was viewed by salesmen as a condition of their First Jersey employment. (Dwyer TT 298, 312-12; PX 87 [Cusick 03/08/90] at 26-27.) As with Registered Representative

Questionnaires, these form letters were distributed in office meetings where salesmen were told to sign.[12] (Dwyer TT 284-85; PX 98 [Strong 04/26/89] at 147-148; PX 93 [Nooney 11/29/88] at 34-36.)

54. Defendants called Frederick A. Eyerman, who was Vice President in charge of Compliance at First Jersey from January 1975 until February 1987 (Eyerman TT 2676), as a witness in their case. Eyerman was hired by Brennan and reported to Brennan at First Jersey (Eyerman TT 2683-2684, 2689).

55. Eyerman's credibility was poor. At his sworn deposition in this case, Eyerman denied that he had ever been censured by the NASD. (Eyerman TT 2826- 34, 2841.) In fact, Eyerman was censured by the NASD September 24, 1990 for failing and neglecting, while at First Jersey, to establish, maintain, and/or enforce written procedures which would enable First Jersey to exercise reasonable and proper supervision, and for failing and neglecting to supervise reasonably and properly certain individuals who were brokers, based on customer complaints during the period January 1982 to 1985. The NASD found that First Jersey salesmen had used high pressure sales campaigns involving scripted presentations for a "Stock of the Month," that Eyerman had violated Article III sections 1 and 27 of the association's rules of fair practice, and that his conduct was inconsistent with high standards of commercial honor and just and equitable principles of trade. Eyerman consented to these findings. (PX 78; Eyerman TT 2825-2849.)

56. At trial, Eyerman also testified that the NASD "never brought [any mark-up problems] to my attention." (Eyerman TT 2752.) But on October 28, 1986, the NASD Market Surveillance Committee issued a decision finding First Jersey, Brennan, and Nadino guilty of charging excessive markups in Transnet between December 12 and 16, 1983 (Eyerman TT 2851;

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[12] First Jersey salesmen signed other documents such as affidavits (*e.g.*, DX 11) and "Affirmation Statements" (*e.g.*, DX 14 and 15) under the perception that signing was a condition of employment. (Dwyer TT 298-99.)

PX 74), and Eyerman was aware of the Transnet matter when he gave his trial testimony (Eyerman TT 2851).

57. Eyerman's testimony regarding how he discharged his responsibilities for compliance with the markup rules in First Jersey principal transactions (Eyerman TT 2707-2708) is illustrative of his overall approach to compliance matters. According to Eyerman, as an initial matter it was the responsibility of the trading department, headed by Tony Nadino after 1982, to establish markups on First Jersey's principal sales to retail customers. (Eyerman TT 2707, 2739.) First Jersey's Compliance Department then examined the trading department's records in search of "red flags," such as a large spread between First Jersey's acquisition cost and its sales price to retail customers. (Eyerman TT 2709, 2781-2782.) However, Eyerman believed that the only acquisition cost that was relevant to markup calculation was the cost in a transaction on the same day as the sale (Eyerman TT 2783-2784); if First Jersey's acquisition of a security occurred prior to the day it was sold to a retail customer, Eyerman ignored the cost of acquiring the security for markup purposes. (Eyerman TT 2793.)

58. Eyerman conceded that First Jersey dominated the market for Sovereign, Rampart and Quasar. (Eyerman TT 2860-2861.) However, he was unaware* that the markup rules required First Jersey to use a different benchmark for prevailing market price where it dominated and controlled the market for a security it sold, compared to the benchmark it was permitted to use where it was selling in an active and competitive market. (Eyerman TT 2797.) First Jersey's supervisory procedures contained no different directions to the trading department for calculating markups in a market that First Jersey dominated and controlled than in an active and competitive market (Eyerman TT 2793-2794), and First Jersey's trading department used the same markup calculation method in both those cases. (Eyerman TT 2796-7.)

59. According to Eyerman's testimony First Jersey's "method" for enforcing compliance with the markup rules was not designed to, and would not, detect the markup violations alleged in the Complaint; that method was limited to examination of order tickets, and ignored both First Jersey's acquisition cost for the

securities it sold and the volume of the securities that First Jersey acquired. (Eyerman TT 2708, 2710, 2791-2793.)

B. Defendant Robert E. Brennan's Activities at First Jersey Through January 31, 1987

60. Defendant Robert E. Brennan ("Brennan") was one of the founders of First Jersey. (Def. Adm. Resp., ¶ 15, Tr. 1912; Brennan TT 1296.)

61. From November 1, 1982 through the present, Brennan has owned 100 percent of the issued and outstanding stock of First Jersey. (Def. Adm. Resp., ¶ 16, Tr. 1912-13; Brennan TT 1296.) Throughout that period, First Jersey was organized as a Subchapter S corporation. (Brennan TT 1439.)

62. Throughout the period November 1, 1982 through January 31, 1987, Brennan was a director of First Jersey. (Def. Adm. Resp., ¶ 18, Tr. 1913; Brennan TT 1295-1296.)

63. From January 1, 1982 through August 1985, Brennan was the President and the highest-ranking officer of First Jersey. (Brennan TT 1289; Def. Adm. Resp., ¶ 17, Tr. 1913.)

64. From approximately September 1985 until approximately September 1986, Brennan was the Chief Executive Officer and Chairman of the Board of First Jersey. (Proxy Statement attached to Form 10-Q filed by International Thoroughbred Breeders, Inc. for quarter ended December 31, 1991, PX 226 at Bates No. 000580; see Brennan TT 1292-1293.)

65. From January 1, 1982 through January 31, 1987, Brennan possessed the power to direct or control, or cause the direction or control of, the management and policies of First Jersey. (Brennan TT 1297-1298; Barnett TT 5380;

66. From November 1, 1982 through at least late 1985, the heads of First Jersey's Research, Compliance, Sales, Operations, and Trading Departments reported to Brennan. (Brennan TT 1312-1322; PX 86 [Brennan 05/22/91] at 127-129.)

67. From November 1, 1982 through at least late 1985, Brennan had the power to hire and fire all First Jersey Department

heads. (Brennan TT 1459; PX 86 [Brennan 05/22/91] at 136-137.)

68. From November 1, 1982 through at least late 1985, Brennan had the power to determine the commission rates of all top management personnel at First Jersey, and also had "the most important voice" in determining their salaries. (PX 86 [Brennan 05/22/91] at 137-143.)

69. From November 1, 1982 through at least late 1985, Brennan had the regular practice of approving First Jersey research reports before those reports were distributed to branch offices of the firm. (Brennan TT 1529, 1531-32.)

70. Brennan periodically received reports that reflected First Jersey's positions in various securities. (Brennan TT 1459.) From November 1, 1982 through at least late 1983, First Jersey's Written Supervisory Procedures covering "Trading Room Activity" required that "In the case of any trade exceeding the extended price of $50,000.00, the President of the firm [*i.e.*, Brennan] must approve the transaction *prior* to the execution" [emphasis in original]. (PX 40 at § 15(f).) Typically, Brennan participated in First Jersey's decisions to split "unit" securities underwritten by the firm into their component securities (Brennan TT 1396), as more fully described below.

71. From January 1, 1982 through at least June 1985, Brennan made the final decisions concerning which companies First Jersey would underwrite. (Brennan TT 1499-1500.)

72. Brennan participated in meetings with First Jersey trading personnel, including Anthony Nadino, First Jersey's Head Trader and Brennan's brother-in-law, concerning First Jersey's markup policies. (Brennan TT 1532-1534, 1540, 1723; PX 86 [Brennan 05/24/91] at 222-223.) Brennan worked very closely with First Jersey's Trading Department and with Mr. Nadino specifically. (Eyerman TT 2815.) Brennan discussed compliance procedures, including First Jersey's compliance with the regulatory agencies' markup standards, with Frederick Eyerman, First Jersey's Head of Compliance. (Eyerman TT 2676, 2814-2815.)

73. During the calendar years 1982 through 1987, Brennan received cash compensation from First Jersey in the form of checks that were prepared whenever, and in whatever amount, Brennan specified. (Brennan TT 1546; Barnett TT 5314-5315.)

74. During the calendar years 1982 through 1987, Brennan received $20,700,694.39 in reported cash compensation from First Jersey, as follows:

Year	Reported on Form W-2	Reported on Form 1099	Annual Total
1982	$ 544,000	$3,439,775	$3,983,775
1983	$ 853,000	$2,262,438.04	$3,115,438.04
1984	$ 760,000	$2,659,000	$3,419,000
1985	$1,520,000	$1,918,680	$3,438,680
1986	$ 707,676.55	$2,590,000	$3,297,676.55
1987	$1,655,000	$1,791,124.80	$3,446,124.80

(First Jersey Forms W-2 and 1099 for Brennan, PX 41.)

C. The Securities Markets at Issue in This Case

79. All of the securities at issue at the trial of this case were traded over the counter ("OTC") (Haft TT 607; DX 402.)

80. OTC securities are securities which are not listed on any national exchange such as the New York Stock Exchange or the American Stock Exchange, nor any regional exchange such as the Philadelphia Stock Exchange or the Pacific Stock Exchange.

81. Broker-dealers who wished to indicate their interest in buying or selling OTC securities during 1982-1987 could submit their names, with or without bid and asked quotations, to the National Daily Quotation Service "pink sheets," which were circulated daily to broker-dealers who subscribed to that service. "Pink sheet" stocks are not generally listed in daily newspapers. (Haft TT 575-580; *see also SEC* v. *Wellshire Securities, Inc.*, 737 F. Supp. 251, 255 n.7.)

82. For OTC securities during 1982-1987, NASDAQ and the "pink sheets" represented the only means, other than random encounters, by which one broker-dealer could learn that

another broker-dealer had an interest in buying or selling the security. (Haft TT 595-596, 703-705.) Therefore, when reference is made herein to the "interdealer market" for a security, such a reference means trading involving broker-dealers whose names appeared in NASDAQ or in the "pink sheets" for that security during the relevant period.

83. A "markup" is the compensation that a broker/dealer receives for effecting a principal transaction with a customer; it is the difference between the retail sales price and the "prevailing market price" of the security. (Haft TT 582, 789.) The National Association of Securities Dealers limits broker/dealers to a 5% markup over prevailing market price. (Haft TT 582.) Securities and Exchange Commission decisions define markups in excess of 10% over prevailing market price as fraud per se. (Haft TT 583, 782, 787.)

84. The purpose of these standards for markups is to protect investors from overreaching by a broker/dealer in a segment of the market where generally available information about prevailing market price and volume is significantly less than in other market segments. (Haft TT 583.) In non-NASDAQ OTC transactions, public investors generally have no information about actual sales prices or volumes of given securities; indeed, at the time of the trades at issue in this case, there was no real time reporting of price or volume in the OTC market. (Haft TT 575-576, 796.)

a. *Qualifications*

86. The Commission's principal expert witness was Professor Robert Haft of the Georgetown University Law Center. Professor Haft teaches a general survey course in federal securities regulation, which includes the law of markups, and a seminar on current issues in securities regulation, among other courses. (Haft TT 571, 746, 750.) Prior to becoming a professor at Georgetown, Professor Haft practiced for twenty-two years in the field of federal securities law and regulation. (Haft TT 571.) In his private law practice, Professor Haft participated in and advised clients with respect to 200 public offerings in OTC securities. (Haft TT 572.)

Using Section 3(a)(38) of the Exchange Act, a "market maker" in a security is a broker-dealer who holds himself out to the broker-dealer community as one who stands ready to purchase and sell that security at particular quoted bid and asked prices and who does, as proved by actual transactions, make a continuous, two-sided market in that security. (Haft TT 589-591.) *See also Sacks Investment Company, Inc.*, 54 S.E.C. Docket 784, at n. 11 (June 9, 1993). A broker/dealer's appearance in the "pink sheets," where bid and ask prices for non-NASDAQ OTC stocks were listed, is merely an invitation to the broker/dealer community to call the listing broker for a possible price quote; a listing in the pink sheets is not sufficient evidence to characterize a broker/dealer as a market maker. (Haft TT 580, 604.)

96. Accordingly, based on the trading in the securities at issue in this case, First Jersey was not a market maker in any of the securities at issue in this case, but rather acted as a retail dealer in those securities. (Haft TT 587, 591-592, 604, 632, 665, 682-683, 689, 692-693, 696.) First Jersey's business was essentially an in-house retail business: the overwhelming volume and number of its transactions were retail; its profits were overwhelmingly derived from retail transactions with its own customers; and its interdealer or wholesale trading was comparatively small and sporadic, not regular or continuous. (Haft TT 592-595, 601, 619, 745.) First Jersey's prices to its retail customers (who had no information about interdealer pricing or volume) were independent of the interdealer market prices. (Haft TT 745.)

97. A broker/dealer controls the market for a security when it dominates trading in that market to the degree that it is able to set the price of the security. (Haft TT 605, 733.) The relevant market for a security is the entire market, composed of the combined wholesale and retail market. (Haft TT 605.) An active and competitive market, as compared with a market that is dominated and controlled, is characterized by the presence of many market makers, high volume, narrow spreads between bid and ask prices, and relatively widespread interest in the security. (Haft TT 605-607.)

98. None of the markets for the securities at issue were competitive, and none were active save for Rampart. (Haft TT 607-8.) First Jersey dominated and controlled the markets for all nine securities at issue in this case: Sovereign common and warrants, Rampart common, Quasar common and warrants, Transnet W2 and W4 warrants, Sequential common, and QT&T common. (Haft TT 587, 632, 656, 665-666, 674-675, 681, 685, 693-698.) The source of supply of each of the securities at issue was substantially all in the hands of First Jersey customers (Haft TT 609; PX 20), and First Jersey had the overwhelming preponderance of transactions in the securities at issue during the time periods involved. (Haft TT 609, 611-614 & PX 28.) In the five instances in which the proof in this case focused on First Jersey's trading in the immediate aftermath of a "unit" offering underwritten by the firm, First Jersey had acted as the sole underwriter of each of the issues and therefore owned 100% of the "units" at the time of each offering; no other broker-dealer even attempted to make a market in the units that First Jersey had sold to its retail customers. (Haft TT 610, 699.)[16]

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[16] Professor Haft also observed that First Jersey's domination and control of the markets for the securities of four of the issuers—Sovereign, Quasar, Transnet, and QT&T—is illustrated by First Jersey's massive overallotments, or oversales, during the unit offerings. Thus, First Jersey sold 580,000 unregistered units of Sovereign, a 70% overallotment (Haft TT 649-51); more than 1.6 million unregistered units of Quasar, a 50% overallotment (Haft TT 675); more than 3.2 million unregistered units of Transnet, a 50% overallotment (Haft TT 683); and more than 3.6 million unregistered units of QT&T, an overallotment of more than 100% (Haft TT 694).

Such overallotments, which were independent violations of the securities laws (Haft TT 651, 676, 684), were extremely unusual and cannot be justified by a legitimate desire to stabilize the price of the offering or protect the underwriter against customer cancellations. (Haft TT 649-51.) First Jersey's willingness to take the substantial short positions that are involved in those overallotments is an indication of the firm's confidence in its control over the securities at issue (see Haft TT 655-656 ("This is in-house. It is only their customers who they are buying from and selling to. It is a closed game, a closed system."). Haft also pointed out that to the extent First Jersey sold units short and then bought them back from the customers at a small "profit," First Jersey could encourage the customer to "move on with that profit to some other stock [the firm] may be recommending") (Haft TT 656).

(continued...)

99. First Jersey was not a market maker in any of the relevant securities and did dominate and control the markets for those securities. Accordingly, First Jersey's contemporaneous cost should be measured by the price it paid to its retail customers to acquire the security. With respect to Rampart General, the relevant acquisition cost was the cost that First Jersey paid to acquire the common stock from the customers.

With respect to markups in the securities of the remaining five issuers as to which there was proof at trial, Professor Haft looked to First Jersey's cost to repurchase "unit" securities consisting of one or more shares of common stock and, in all cases but Sequential, one or more warrants.

100. To calculate First Jersey's contemporaneous cost in those instances—Sovereign, Quasar, and Transnet—where the "unit" was composed of a combination of common stock and warrants and where First Jersey sold *both* the common and the warrants to customers in the aftermarket, the Commission's methodology [*which the Court accepts and applies] was to determine First Jersey's cost to acquire the "unit," and then to allocate that acquisition cost to the common and the warrants in proportion to the prices that First Jersey charged for those securities in the aftermarket. The Commission offered the following "Illustration of Unit Cost Allocation" as Plaintiff's Exhibit 10B:

— On day one, First Jersey buys units back from customers for $1.00 per unit. Each unit consisted of two shares of stock and one warrant.

— On the same day, First Jersey sells the common stock to customers at $.75 per share and sells the warrants for $.50 apiece. These sales prices were

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[16] (...continued)

Defendants' markup expert Shaeffer also testified that he had never seen the sale of an overallotment as large as those First Jersey sold in the offerings in this case, and that those sales raised the question in his mind whether FJ was engaged in the sale of unregistered securities, in violation of Section 5 of the Exchange Act. (Shaeffer TT 4136, 4139, 4143.) However, Shaeffer made no inquiry of the defendants or their lawyers concerning those overallotments. (Shaeffer TT 4142.)

then used to derive a sales price for a unit equivalent (once again, consisting of two shares of stock and one warrant):

Sales Price of Common	= $ .75 x 2 =	$1.50
Sales Price of Warrant	= $ .50 x 1 =	$ .50
		$2.00

Each common share thus accounted for 37.5% of the total sales price of the unit equivalent ($0.75/$2.00), and each warrant accounted for 25% ($0.50/ $2.00).

Allocation of Cost

As noted above, First Jersey paid $1.00 for each unit. The percentages derived above (37.5% for common shares and 25% for warrants) were then used to allocate the $1.00 cost of the units between the common shares ($.375 apiece) and the warrant ($.25).

— The $.375 cost for common was then used (after allowing First Jersey a 10% markdown) as First Jersey's contemporaneous cost to calculate its markups on the common shares that it sold to customers.

— The $.25 cost for warrants was then used (after allowing First Jersey a 10% markdown) as First Jersey's contemporaneous cost to calculate its markups on the warrants that it sold to customers.[17/]

101. I accept and apply the allocation method as a reasonable basis for allocating the cost of unit components in this case. For pricing purposes, the units in this case are equivalent to

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[17/] With respect to Sequential—where the "unit" consisted simply of a bundle of fifty common shares with no other security involved—the allocation process involved nothing more complex than dividing First Jersey's price to acquire the unit by fifty. And in the case of QT&T—where the unit originally consisted of two common shares and a warrant but where First Jersey, after splitting up the "units," only sold the common shares to its customers and did not retail the warrants—all of the cost of the units was allocated to the common shares, thus charging defendants with the minimum possible unlawful markup.

their components; they were created by First Jersey and had no independent existence.

102. Further, there existed here a pattern of unit offerings followed closely by a repurchase of all or substantially all of the units which was extremely unusual (Haft TT 701-702), and on the basis of First Jersey's conduct in this case, it is clear that the firm planned, at the time of each underwriting, to break down the units shortly thereafter.

D. Trading in Securities of Sovereign Chemical & Petroleum Products, Inc. Between November 9, 1982 and December 1, 1982

137. On November 9, 1982, First Jersey entered into an Underwriting Agreement with Sovereign Chemical & Petroleum Products, Inc. ("Sovereign"). (Sovereign Underwriting Agreement, PX 42.)

138. Brennan signed the Sovereign underwriting agreement on behalf of First Jersey. (*Id.*)

139. The Sovereign offering was declared effective on November 9, 1982. (Sovereign Prospectus, PX 1.)

140. On November 9, 1982, with Brennan's authorization, First Jersey acted as the sole underwriter of 1,000,000 "units" of Sovereign, each unit priced at $3.00 and consisting of three shares of common stock and one warrant exercisable for $3.00 per share until November 10, 1987, plus an overallotment option of 100,000 additional units. (Sovereign Prospectus, PX 1; Def. Adm. Resp., PX 62 at ¶¶ 26(b), 28(b).)

141. With respect to the Units, the Sovereign prospectus stated that "[t]he Warrants will not be separately transferable from the Common Stock until May 8, 1983 or such earlier date as may be elected by the Underwriter." (Sovereign Prospectus, PX 1.)

142. The Sovereign offering was oversold in that First Jersey sold 1,688,375 Sovereign units to its customers, compared to the 1,100,000 units that were registered. (Summary of First Jersey Trading Activity—All Issues, PX 9C; Outline of FJ Transactions, PX 20.)

143. Four First Jersey branch offices accounted for more than 99% of the customer purchases of Sovereign units. (First Jersey Securities—Net Customer Trades (by Branch): Rampart and Sovereign, PX 19; *cf.* Def. Adm. Resp., PX 62 ¶ 28(c) (units sold to "at least three ... branch offices").)

144. Before the November 9, 1982 underwriting, Sovereign units did not exist, and Sovereign common stock and warrants were not traded publicly. (Sovereign Prospectus, PX 1 at 1.)

145. Between November 9, 1982, and December 1, 1982, Sovereign securities were not quoted on NASDAQ. (Sovereign Pink Sheets, PX 23.)

146. One broker-dealer appeared, without price quotations, in the National Daily Quotation Service "pink sheets" for Sovereign units between November 19, 1982 and December 1, 1982.[18] That broker-dealer made no purchases and no sales of Sovereign units during that period. (Broker-Dealer Trading Data Schedule for Sovereign, PX 8.)

147. Between November 11, 1982 and November 22, 1982, First Jersey repurchased approximately 1.5 million Sovereign units from its customers at prices ranging from $3.25 to $3.75 per unit, as follows:

Date	Price	# of Units Repurchased
Nov. 11	$3.313	100,000
Nov. 17	$3.313	34,000
	$3.250	16,000
Nov. 18	$3.50	1,163,200
Nov. 19	$3.50	159,300
Nov. 22	$3.75	50,350

(First Jersey Trading Activity Schedule, PX 9; *cf.* Def. Adm. Resp., PX 62 ¶¶ 28(d)-(e).)

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[18] A complete listing of all "pink sheet" entries in Sovereign securities appears as Appendix A hereto.

148. First Jersey did not disclose to the customers from whom it repurchased the Sovereign units the fact that First Jersey intended to split up the units so that the component common stock and warrants would trade separately. (Brennan TT 1407; PX 98 [Strong 03/16/89] at 106-107.)

149. First Jersey caused the units that it had repurchased from its customers to be split immediately so that the component common stock and warrants became separately transferable. (November 22, 1982 Letter from Barnett to Sovereign, PX 81; Def. Adm. Resp., PX 62 ¶ 28(f).)

1. Sovereign Common Stock

150. Net of cancellations, between November 22, 1982 and November 30, 1982, First Jersey sold approximately 2.9 million shares of Sovereign common stock to its customers at prices ranging from $2.25 per share to $3.00 per share. (Sovereign Markup Schedule, PX 10.)

151. First Jersey did not provide the customers to whom it sold Sovereign common stock with the prospectus for the Sovereign unit offering of November 9, 1982. (*Compare* First Jersey P&S Blotter, PX 170 at page SEC# 01530, *with id.* pages SEC# 03102, 05444, 05829, 07668, 07705, 07742, 07806; *see also* Dwyer TT 107-111.) Nor did First Jersey disclose to those customers the price at which First Jersey had re-acquired the units. (Brennan TT 1518-1522.)

152. Between November 23, 1982 and November 30, 1982, First Jersey purchased a total of 173,100 shares of Sovereign common stock from its customers at $1.75 per share. (Sovereign Markup Schedule, PX 10; Sovereign Chemical Broker Dealer Volume—Common, PX 18.)

153. Three broker-dealers, including First Jersey, appeared (without price quotations) in the National Daily Quotation

Service "pink sheets" for Sovereign common stock between November 19, 1982 and December 1, 1982.[19/]

154. Excluding transactions involving First Jersey, broker-dealers listed in the "pink sheets" purchased no shares of Sovereign common stock and sold 9,300 shares of Sovereign common stock between November 22 and December 1, 1982. During this period, First Jersey made no purchases of Sovereign common stock and sold 1,000 shares of Sovereign common stock in the interdealer market. Prices in the interdealer market ranged from $1.625 to $2.75 per share. (First Jersey/Broker Dealer Volume Summary for Sovereign, PX 18; Broker Dealer Trading Data Schedule, PX 8; Haft TT 594-595.)

155. When First Jersey's retail transactions are combined with the interdealer trading, First Jersey had 100% of the "buy" side of the market for Sovereign common stock and 99.7% of the "sell" side of the market for Sovereign common stock between November 9, 1982 and December 1, 1982. (First Jersey/Broker Dealer Volume Summary for Sovereign, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

156. First Jersey was not a market maker in Sovereign common stock between November 22, 1982 and December 1, 1982. (Haft TT 631-632.)

157. Between November 9, 1982 and December 1, 1982, First Jersey dominated and controlled the market for Sovereign common stock. (Haft TT 631-632; PX 28.)

158. Because First Jersey was not a market maker in Sovereign common stock, and because First Jersey in any event dominated and controlled the market for Sovereign common stock, First Jersey's contemporaneous cost to acquire the Sovereign common stock that it sold to its customers is the best evidence of the prevailing market price for that stock. (Haft TT 618-620.)

159. First Jersey's contemporaneous cost to acquire the approximately 2.9 million shares of Sovereign common stock that

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[19/] A complete listing of all "pink sheet" entries in Sovereign securities appears as Appendix A hereto.

it sold to its customers between November 22, 1982 and November 30, 1982 did not exceed the $3.75 that First Jersey paid to repurchase Sovereign units from its customers on November 22, 1982, allocated among the common stock and warrants comprising the unit and giving First Jersey an allowance for a 10% markdown. (Haft TT 633-634.)[20/] First Jersey's contemporaneous cost to acquire those shares therefore did not exceed $1.21-$1.25 per share. Nevertheless, First Jersey sold Sovereign common stock to its customers at $2.25 to $3.00 per share between November 22, 1982 and November 30, 1982, yielding percentage markups ranging from 83.6% to 140%. (Sovereign Markup Schedule, PX 10.)

2. Sovereign Warrants

160. Net of cancellations, between November 24, 1982 and December 1, 1982 First Jersey sold approximately 1.4 million Sovereign warrants to its customers at $1.00 per warrant. (Sovereign Markup Schedule, PX 10.)

161. First Jersey did not provide the customers buying Sovereign warrants with the prospectus for the Sovereign unit offering of November 9, 1982. (*Compare* First Jersey P&S Blotter, PX 170 at page SEC# 01530 *with id.* pages SEC# 07671, 05666, 07707, 07747, 07806; *see also* Dwyer TT 107-111.) Nor did First Jersey disclose to those customers the price at which First Jersey had reacquired the units. (Brennan TT 1518-1522.)

162. Between November 23, 1982 and December 1, 1982, First Jersey purchased approximately 46,000 Sovereign warrants from its customers at $.25 per warrant. (First Jersey Trading Activity Schedule, PX 9.)

[20/] When purchasing securities for its own account from a retail customer, a broker-dealer generally may pay the customer a price that is ten percent *less* than the prevailing market price for that security without violating the securities laws. This ten percent reduction is called a "markdown," as distinct from a "markup," which refers to an additional increment over the prevailing market price that a broker-dealer charges to a customer who is *buying* a security from the broker-dealer. (Haft TT 625-626.)

163. No broker-dealers appeared in the National Daily Quotation Service "pink sheets" for Sovereign warrants between November 19, 1982 and December 1, 1982.[21/]

164. First Jersey had one transaction with another broker-dealer in Sovereign warrants between November 19 and December 1, 1982: a 2,000-warrant sale by First Jersey at $.875 per warrant. There were no other interdealer transactions in Sovereign warrants during the period. (Broker Dealer Trading Data Schedule, PX 8.)

165. First Jersey was not a market maker in Sovereign warrants between November 19, 1982 and December 1, 1982. (Haft TT 632.)

166. Between November 19, 1982 and December 1, 1982, First Jersey dominated and controlled the market for Sovereign warrants. (Haft TT 632; PX 28.)

167. Because First Jersey was not a market maker in Sovereign warrants, and because First Jersey in any event dominated and controlled the market for Sovereign warrants, First Jersey's contemporaneous cost to acquire the Sovereign warrants that it sold to its customers is the best evidence of the prevailing market price for those warrants. (Haft TT 618-620.)

168. First Jersey's contemporaneous cost to acquire the 1.4 million Sovereign warrants that it sold to customers between November 24, 1982 and December 1, 1982, did not exceed the $3.75 that First Jersey paid to repurchase Sovereign units from its customers on November 22, 1982, allocated among the common stock and warrants comprising the unit and giving First Jersey an allowance for a 10% markdown. First Jersey's contemporaneous cost to acquire those warrants therefore did not exceed $.417-$.45 per warrant. Nevertheless, First Jersey sold Sovereign warrants customers at $1.00 per warrant between November 24-December 1, yielding percentage markups ranging from 122% to 140%. (Sovereign Markup Schedule, PX 10.)

[21/] A complete listing of all "pink sheet" entries in Sovereign securities appears as Appendix A hereto.

169. Using the method for calculating markups described in Findings 159 and 168 above, between November 22, 1982 and December 1, 1982, First Jersey charged its customers $5,170,152 in markups which exceeded ten percent on those customers' purchases of Sovereign common stock and warrants, or $4,368,791 when cancelled transactions are taken into account. (Sovereign Markup Schedule, PX 10.)

170. First Jersey's gross profit from its sales of Sovereign common stock and warrants to customers between November 22 and December 1, 1982, using First Jersey's actual cost of repurchasing Sovereign units as set forth in Finding 147 above, was $5,172,292. (FJS Disgorgement Calculation, PX 21).[22/]

E. Trading in Common Stock of Rampart General, Inc. Between November 3, 1982 and December 3, 1982

173. On May 14, 1982, First Jersey entered into an Underwriting Agreement with Rampart General, Inc. ("Rampart"). (Rampart Underwriting Agreement, PX 46.)

174. Brennan signed the Rampart underwriting agreement on behalf of First Jersey. (*Id.*)

175. On May 14, 1982, with Brennan's authorization, First Jersey acted as the sole underwriter of 2,500,000 "units" of Rampart, each unit priced at $1.00 and consisting of three shares of common stock and one warrant exercisable for $1.00 per share until August 31, 1984 and for $2.00 per share until August 31, 1987 (the "1987 Warrants"), plus an overallotment option of

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[22/] I find that the SEC's proposed disgorgement figures are clearly "a prima facie reasonable approximation; and the risk of uncertainty [falling] on the wrongdoer," *SEC* v. *Drexel Burnham Lambert Inc.*, 837 F. Supp. at 612. I also note that although the defendants took sharp issue with the SEC's methodology and its underlying assertions as to sales practices, they were in possession of these figures prior to trial from the SEC's Pretrial Proposed Findings, and took no issue on the trial or in subsequent briefing as to the figures, assuming the SEC's methodology was accepted by the Court. Accordingly, I accept the SEC's figures on disgorgement.

250,000 additional units. (Rampart Prospectus, PX 7; Def. Adm. Resp., PX 62 ¶¶ 26(b), 29(b).)

176. With respect to the Units, the Rampart prospectus stated that "[t]he Common Stock and Warrants will not be separately transferable until September 1, 1982 or such earlier date as may be elected by the Underwriter." (Rampart Prospectus, PX 7 at 1.)

177. First Jersey sold the Rampart units to its customers. (PX 19.)

178. First Jersey caused the Rampart units that it had sold to its customers to be split so that the component common stock and warrants became separately transferable. (May 27, 1982 Letter from Barnett to Bank of America NT & SA, PX 80.)

179. Rampart common stock was quoted on NASDAQ between November 1, 1982 and November 15, 1982, but was not quoted on NASDAQ from November 16 to December 3, 1982. Between November 1 and November 15, the information reported on NASDAQ concerning Rampart common stock was as follows:

		Previous Week			
Date	Volume	High Bid	Low bid	Bid	Asked
Nov. 1	393	1	15/16	1	1 1/8
Nov. 2	393	1	15/16	1	1 1/16
Nov. 3	393	1	15/16	15/16	1 1/16
Nov. 4	393	1	15/16	15/16	1 1/16
Nov. 5	393	1	15/16	15/16	1 1/16
Nov. 8	499	1	15/16	15/16	1 1/16
Nov. 9	499	1	15/16	1 1/16	1 3/16
Nov. 10	499	1	15/16	1 ⅛	1 3/16
Nov. 11	499	1	15/16	1 ¼	1 5/16
Nov. 12	499	1	15/16	1 ¼	1 3/8
Nov. 15	1350	1 1/2	15/16	1 ½	1 9/16

(Rampart Pink Sheets, PX 22.)

180. On each trading day between November 3, 1982 and December 2, 1982, between five and seven broker-dealers, including First Jersey, appeared in the National Daily Quotation Service "pink sheets" for Rampart common stock.[23/]

181. Between November 2, 1982 and November 17, 1982, First Jersey entered into a series of transactions with other broker-dealers in which First Jersey purchased small quantities of Rampart common stock at successively higher prices, ranging from $.938 per share on November 2, 1982 to $2.125 per share on November 17. In total, First Jersey purchased 125,020 Rampart common shares from dealers, and sold only 500 shares to dealers, between November 2 and November 17. (Broker-Dealer Trading Data Schedule, PX 8.)

182. Between November 12, 1982 and November 16, 1982, First Jersey purchased approximately 1.9 million shares of Rampart common stock from First Jersey retail customers at $1.50 per share. Beginning on November 17 and continuing through December 3, First Jersey purchased another 300,000 Rampart common shares from customers at $1.75 per share. (Rampart Markup Schedule, PX 11.)

183. On November 18, 1982, First Jersey began retailing Rampart common shares to its customers at $2.50 per share. Net of cancellations, between November 18 and December 3 First Jersey sold approximately 2.2 million Rampart shares to its customers at the $2.50 price. (Rampart Markup Schedule, PX 11.)

184. Excluding transactions involving First Jersey, broker-dealers appearing in the "pink sheets" purchased 103,440 shares of Rampart common and sold 18,750 shares of Rampart common between November 5 and December 3, 1982. During this period, First Jersey bought 186,235 shares of Rampart common stock and sold 5,500 shares of Rampart common stock in the interdealer market. Prices in the interdealer market ranged from $.938 to $2.5 per share. (First Jersey/Broker Dealer Volume

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[23/] A complete listing of the "pink sheet" entries for Rampart securities (with price quotations, if any, as shown) appears in Appendix B hereto.

Summary for Rampart, PX 18; Broker Dealer Trading Data Schedule, PX 8; Haft TT 600-601.)

185. By its purchases of Rampart common stock in the interdealer market between November 5, 1982 and December 3, 1982, First Jersey raised the price of Rampart common in that interdealer market from $.938 per share to $2.5 per share. (Haft TT 668-669; Broker Dealer Trading Data Schedule, PX 8.)

186. When First Jersey's retail transactions are combined with the interdealer trading, First Jersey had 95.9% of the "buy" side of the market for Rampart common stock and 99.2% of the "sell" side of the market for Rampart common stock between November 5, 1982 and December 3, 1982. (First Jersey/Broker Dealer Volume Summary for Rampart, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

187. First Jersey was not a market maker in Rampart common stock between November 3, 1982 and December 3, 1982. (Haft TT 665.)

188. Between November 3, 1982 and December 3, 1982, First Jersey dominated and controlled the market for Rampart common stock. (Haft TT 665, 672; PX 28.)

189. Because First Jersey was not a market maker in Rampart common stock between November 3, 1982 and December 3, 1982, and because First Jersey dominated and controlled the market for Rampart common stock, First Jersey's contemporaneous cost to acquire the Rampart common stock that it sold to its customers is the best evidence of the prevailing market price for that stock. (Haft TT 664-665.)

190. First Jersey's contemporaneous cost to acquire the 77,700 shares of Rampart common stock that it sold to its customers at $1.188 to $1.563 per share between November 3, 1982 and November 12, 1982 did not exceed the $.938 to $1.50 that First Jersey paid to buy Rampart common shares from other broker-dealers, yielding percentage markups from -8.3% (one transaction) to 26.7%. (Rampart Markup Schedule, PX 11.)

191. First Jersey's contemporaneous cost to acquire the 2500 shares of Rampart common stock that it sold to customers on

November 15-16, 1982 did not exceed the $1.50[24/] that First Jersey paid to acquire Rampart common stock from its customers beginning on November 12, 1982, after an allowance for a 10% markdown.

First Jersey's contemporaneous cost for the Rampart common stock that it sold to customers at $2.25 per share on November 15-16 therefore did not exceed $1.667 per share, yielding a percentage markup of 35%. (Rampart Markup Schedule, PX 11.)

192. First Jersey's contemporaneous cost to acquire the approximately 2.1 million shares of Rampart common stock that it sold to customers on November 18-December 3, 1982 did not exceed the $1.75 that First Jersey paid to acquire Rampart common stock from its customers beginning on November 17, 1982, after an allowance for a 10% markdown. First Jersey's contemporaneous cost for that stock therefore did not exceed $1.944. Nevertheless, First Jersey sold Rampart common stock to its customers at $2.50 between November 18 and December 3, 1982, yielding percentage markups of 28.6%. (Rampart Markup Schedule, PX 11.)

193. Using the method for calculating markups described in Findings 190-192 above, between November 3, 1982 and December 3, 1982, First Jersey charged its customers $1,286,842 in markups which exceeded ten percent on those customers' purchases of Rampart common stock, or $1,195,234 when cancelled transactions are taken into account. (Rampart Markup Schedule, PX 11.)

194. First Jersey's gross profit from its sales of Rampart common stock to customers between November 3 and December 3, 1982, using First Jersey's actual cost of purchasing Rampart

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[24/] Here and hereafter there are a few individual figures, both higher and lower, which, however, essentially balance to the basic figure overwhelmingly revealed by the First Jersey records, and therefore these findings can be fairly based on the basic figure. Accordingly, the contemporaneous cost to First Jersey is that at which almost all of the multitudinous purchases were made, unaffected by stray purchases above *or* below the basic cost.

common stock above, was $2,110,617. (FJS Disgorgement Calculation, PX 21.)

F. Cross-Trading Among First Jersey Offices in Securities of Sovereign and Rampart Between November 12, 1982 and December 2, 1982

200. Between November 12, 1982 and December 2, 1982, First Jersey caused various of its branch offices to recommend that their customers sell Rampart common stock and buy Sovereign common stock and warrants, while at or about the same time it caused other branch offices to recommend that customers sell Sovereign units and buy Rampart common stock. (First Jersey Securities: Net Customer Trades (by Branch): Rampart and Sovereign, PX 19.)

201. In particular, customers of four First Jersey offices—# 89 (Falls Church, VA), # 59 (Atlanta, GA), # 84 (Red Bank, NJ) and # 66 (North Palm Beach, FL)—provided 100% of the Sovereign units that First Jersey bought back from its customers between November 18, 1982 and November 22, 1982. Customers of those four offices, along with customers of Office # 58 (New Orleans, LA) also bought 96.4% of the shares of Rampart common stock that First Jersey sold to customers during that same period. In effect, First Jersey switched customers of those offices out of Sovereign units and into Rampart common stock. (First Jersey Securities: Net Customer Trades (by Branch): Rampart and Sovereign, PX 19.)

202. Simultaneously, customers of five other First Jersey offices—# 87 (Danvers, MA), # 57 (Houston, TX), # 60 (Wayne, PA), # 56 (Rochester, NY), and # 50 (New York, NY)—provided 83.2% of the Rampart common stock that First Jersey bought from its customers. Customers of those five offices also bought 49.9% of the Sovereign common stock and 42.3% of the Sovereign warrants that First Jersey sold to customers during this period. In effect, First Jersey switched customers of these five offices out of Rampart common and into Sovereign common stock and warrants. (First Jersey Securities: Net Customer Trades (by Branch): Rampart and Sovereign, PX 19.)

203. Thus, at the same time that First Jersey was recommending that its Falls Church, Atlanta, Red Bank, and North Palm Beach customers sell Sovereign and buy Rampart, it also recommended that other First Jersey customers in Danvers, Houston, Wayne, Rochester, and New York City sell Rampart and buy Sovereign—permitting First Jersey, by virtue of its own contradictory recommendations, to reap the profits that are described in Findings 170 and 194 above.

G. Trading in Securities of Quasar Microsystems, Inc. Between January 13, 1983 and January 31, 1983

204. In January 1983, First Jersey entered into an Underwriting Agreement with Quasar Microsystems, Inc. ("Quasar").[25/]

205. Brennan signed the Quasar underwriting agreement on behalf of First Jersey. (See note 39 above.)

206. On January 13, 1983, with Brennan's authorization, First Jersey acted as the sole underwriter of 3,000,000 "units" of Quasar, each unit priced at $1.50 and consisting of three shares of common stock and one warrant exercisable for $.75 per share through February 1, 1985 and for $1.00 per share through February 1, 1988 (the "1988 Warrants"), plus an overallotment option of 300,000 additional units. (Quasar Prospectus, PX 2; Def. Adm. Resp., PX 62 ¶¶ 26(b), 30(b).)

207. With respect to the Units, the Quasar prospectus stated that "[t]he Unit Warrants and shares of Common Stock will not be separately transferable or the Unit Warrants exercisable until April 13, 1983 (90 days after the date of this Prospectus) or such

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[25/] Defendants failed to produce the Quasar underwriting agreement, or First Jersey's letter splitting the Quasar units, in discovery in this case (see June 15, 1994 Tr. 1235-36). Accordingly, the Court's Findings of Fact regarding the matters that would have been covered in those documents are based upon the pattern set by First Jersey with respect to the other unit offerings.

Tupman Thurlow Co., Inc. v. *S.S. Cap Castillo*, 490 F.2d 302, 308 (2d Cir. 1974).

earlier date as the Underwriter may determine." (Quasar Prospectus, PX 2 at 1.)

208. The Quasar offering was oversold in that First Jersey sold approximately 4,983,000 units to its customers, compared to the 3,300,000 units that were registered. (First Jersey Trading Activity Schedule, PX 9; Outline of FJ Transactions, PX 20.)

209. First Jersey sold the Quasar units to customers of at least six of its branch offices. (Def. Adm. Resp., PX 62 P 30(c).)

210. These units did not exist before the January 13 public offering. (Quasar Prospectus, PX 2.)

211. Quasar securities were not quoted on NASDAQ between January 13, 1983 and January 31, 1983. (Quasar Pink Sheets, PX 24.)

212. No broker-dealers appeared in the National Daily Quotation Service "pink sheets" for Quasar units between January 13, 1983 and January 31, 1983.[26/]

213. Between January 14, 1983 and January 24, 1983, First Jersey repurchased 4,127,250 Quasar units from its customers at prices of $1.75 or $2.00 per unit, as follows:

Date	Price	# of Units Repurchased
Jan. 14	$1.75	1,343,155
Jan. 17	$1.75	1,957,200
Jan. 18	$1.75	279,150
Jan. 19	$1.75	94,200
	$2.00	95,800
Jan. 20	$2.00	177,420
Jan. 21	$2.00	194,250
Jan. 24	$2.00	31,075

[26/] A complete listing of the "pink sheet" entries for Quasar securities (with price quotations, if any, as shown) appears in Appendix C hereto.

(First Jersey Trading Activity Schedule, PX 9; *cf.* Def. Adm. Resp., PX 62, ¶¶ 30(d)-(e).)

214. First Jersey did not disclose to the customers from whom it repurchased the Quasar units the fact that First Jersey intended to split up the units immediately so that the component common stock and warrants would trade separately. (*See* Brennan TT 1407-1409; Dwyer TT 117; *see* PX 98 [Strong 03/16/89] at 106-107.)

215. First Jersey caused the Quasar units that it had purchased from its customers to be split so that the component common stock and warrants became separately transferable.

1. Quasar Common Stock

216. Net of cancellations, between January 17, 1983 and January 28, 1983, First Jersey sold approximately 7.5 million shares of Quasar common stock to its customers at prices ranging from $1.00 per share to $1.50 per share. (Quasar Markup Schedule, PX 12.)

217. First Jersey did not provide the customers to whom it sold Quasar common stock with the prospectus for the unit offering of January 13, 1983. (*Compare* First Jersey P&S Blotter, PX 171 at page SEC # 015977 *with id.* pages SEC ## 016258, 016686, 017018, 017387, 017967, 018565, 018660, 019124, 019377, 019605.) Nor did First Jersey disclose to those customers the price at which First Jersey had re-acquired the units. (Brennan TT 1518-1522.)

219. On each day between January 10, 1983 and January 28, 1983, between five and seven broker-dealers appeared in the National Daily Quotation Service "pink sheets" for Quasar common stock, one of whom—Jesup & Lamont—provided price quotations. First Jersey did not appear in the "pink sheets" for Quasar until January 20.[27/]

[27/] A complete listing of the "pink sheet" entries for Quasar securities (with price quotations, if any, as shown) appears in Appendix C hereto.

220. Excluding transactions involving First Jersey, broker-dealers listed in the "pink sheets" purchased 27,460 shares of Quasar common and sold 69,230 shares of Quasar common between January 11 and January 31, 1983. Prices in the interdealer market ranged from $.50 to $2.75 per share. During this period, First Jersey bought 5,620 shares of Quasar common stock and sold 47,930 shares of Quasar common stock in the interdealer market. (First Jersey/Broker Dealer Volume Summaries, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

221. When First Jersey's retail transactions are combined with the interdealer trading, First Jersey had 23.7% of the "buy" side of the market for Quasar common stock and 99.1% of the "sell" side of the market for Quasar common stock between January 11, 1983 and January 31, 1983. (First Jersey/Broker Dealer Volume Summaries, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

222. First Jersey was not a market maker in Quasar common stock between January 10 and January 28, 1983. (Haft TT 675, 682-683.)

223. Between January 11, 1983 and January 28, 1983, First Jersey dominated and controlled the market for Quasar common stock. (Haft TT 673-675, 682-683; PX 28.)

224. Because First Jersey was not a market maker in Quasar common stock between January 11, 1983 and January 28, 1983 and because First Jersey in any event dominated and controlled the market for Quasar common stock, First Jersey's contemporaneous cost to acquire the Quasar common stock that it sold to its customers is the best evidence of the prevailing market price for that stock. (Haft TT 681.)

225. First Jersey's contemporaneous cost to acquire the approximately 2.7 million shares of Quasar common stock that it sold to its customers between January 14, 1983 and January 18, 1983, did not exceed the $1.75 that First Jersey paid to repurchase Quasar units from its customers on January 14-18, 1983, allocated among the common stock and warrants comprising the unit and giving First Jersey an allowance for a 10% markdown. First Jersey's contemporaneous cost to acquire that stock therefore did

not exceed $.486 per share. Nevertheless, First Jersey sold Quasar shares to its customers at $1.00 per share on January 17-18, yielding percentage markups of 105.7%. (Quasar Markup Schedule, PX 9.)

226. First Jersey's contemporaneous cost to acquire the approximately 4.6 million shares of Quasar common stock that it sold to its customers between January 19, 1983 and January 28, 1983, did not exceed the $2.00 that First Jersey paid to repurchase Quasar units from its customers on and after January 19, 1983, allocated among the common stock and warrants comprising the unit and giving First Jersey an allowance for a 10% markdown. First Jersey's contemporaneous cost to acquire that stock therefore did not exceed $.585 to $.622 per share. Nevertheless, First Jersey sold Quasar shares to its customers at $1.25 to $1.75 per share on January 20-28, yielding percentage markups ranging from 71% to 188.8%. (Quasar Markup Schedule, PX 12.)

2. Quasar 1988 Warrants

227. Net of cancellations, between January 20, 1983 and January 31, 1983, First Jersey sold approximately 1.7 million Quasar 1988 warrants to its customers at $1.00 per warrant. (Quasar Markup Schedule, PX 12.)

228. First Jersey did not provide the customers to whom it sold Quasar warrants with the prospectus for the unit offering of January 13, 1983. (*Compare* First Jersey P & S Blotter, PX 171 at page SEC # 015977 *with id.* pages SEC ## 017447, 018029, 018570, 018555, 019124, 019354, 019571, and 018560.) Nor did First Jersey disclose to those customers the price at which First Jersey had re-acquired the units. (Brennan TT 1518-1522.)

229. Between January 10, 1983 and January 31, 1983, First Jersey purchased a total of 7,000 Quasar 1988 warrants from its customers at $.875 per warrant. (Quasar Markup Schedule, PX 12.)

230. No broker-dealers appeared in the National Daily Quotation Service "pink sheets" for Quasar 1988 warrants between January 13, 1983 and January 31, 1983.[28/]

231. There were no reported interdealer transactions in Quasar 1988 warrants between January 13, 1983 and January 31, 1983. (Broker-Dealer Trading Data Schedule, PX 8.)

232. First Jersey was not a market maker in Quasar 1988 warrants between January 13, 1983 and January 31, 1983. (Haft TT 675, 682-683.)

233. First Jersey dominated and controlled the market for Quasar 1988 warrants between January 13, 1983 and January 31, 1983. (Haft TT 673-675, 682-683; PX 28.)

234. Because First Jersey was not a market maker in Quasar 1988 warrants and because First Jersey dominated and controlled the market for Quasar 1988 warrants, First Jersey's contemporaneous cost to acquire the Quasar warrants that it sold to its customers is the best evidence of the prevailing market price for those warrants. (Haft TT 681.)

235. First Jersey's contemporaneous cost to acquire the approximately 1.7 million Quasar 1988 warrants that it sold to its customers between January 20, 1983 and January 31, 1983, did not exceed the $2.00 that First Jersey paid to repurchase Quasar units from its customers on and after January 20, 1983, allocated among the common stock and warrants comprising the unit and giving First Jersey an allowance for a 10% markdown. First Jersey's contemporaneous cost to acquire those warrants therefore did not exceed $.404 per warrant. Nevertheless, First Jersey sold Quasar warrants to its customers at $1.00 per warrant on January 20-31, yielding percentage markups of 147.5%. (Quasar Markup Schedule, PX 12.)

236. Using the method for calculating markups described in Findings 225-226 and 235 above, between January 14, 1983 and January 31, 1983, First Jersey charged its customers $6,513,878 in

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[28/] A complete listing of the "pink sheet" entries for Quasar securities (with price quotations, if any, as shown) appears in Appendix C hereto.

markups which exceeded ten percent on those customers' purchases of Quasar common stock and warrants, or $5,809,153 when cancelled transactions are taken into account. (Quasar Markup Schedule, PX 12.)

237. First Jersey's gross profit from its sales of Quasar common stock and warrants to customers between January 14 and January 31, 1983, using First Jersey's actual cost of repurchasing Quasar units as set forth in Finding 213 above, was $6,302,659. (FJS Disgorgement Calculation, PX 21.)

H. Trading in Securities of Transnet Corporation Between November 10, 1983 and December 23, 1983

243. On November 10, 1983, First Jersey entered into an Underwriting Agreement with Transnet Corporation ("Transnet"). (Transnet Underwriting Agreement, PX 43.)

244. Brennan signed the Transnet underwriting agreement on behalf of First Jersey. (*Id.*)

245. On November 10, 1983, with Brennan's authorization, First Jersey acted as the sole underwriter of 2,000,000 "Units" of Transnet, each unit priced at $3.50 and consisting of one share of common stock, one Two Year Warrant ("W2") exercisable for $4.50 per share through November 25, 1985 and one Four Year Warrant ("W4") exercisable for $5.50 per share through November 25, 1987, plus an overallotment option of 300,000 additional units. (Transnet Prospectus, PX 3; Def. Adm. Resp., PX 62 ¶¶ 26(b), 31(b).)[29/]

246. With respect to the Units, the Transnet prospectus stated that "[t]he Unit Warrants and the Common Stock will not be separately transferable or the Unit Warrants exercisable until May 9, 1984 (181 days after the date of this Prospectus) or such

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[29/] Prior to the November 10, 1983 unit offering, Transnet already had two series of warrants outstanding: warrants exercisable for $6.00 per share through January 7, 1985 (extended from January 6, 1983) ("W1"); and warrants exercisable for $10.00 per share through January 6, 1986 ("W3"). (Transnet Prospectus, PX 3 at 29.)

earlier date as the Underwriter, in its sole discretion, may determine." (Transnet Prospectus, PX 3 at 1.)

247. First Jersey sold the Transnet units to customers of its branch offices. (Def. Adm. Resp., PX 62 ¶ 31(c).)

248. The Transnet offering was oversold in that First Jersey sold approximately 3,517,000 units to its customers, compared to the 2,300,000 units that were registered. (First Jersey Trading Activity Schedule, PX 9; Outline of FJ Transactions, PX 20.)

249. Between November 10, 1983 and December 23, 1983, Transnet units were not quoted on NASDAQ. (Transnet Pink Sheets, PX 25.)

250. Between November 10, 1983 and December 23, 1983, no broker-dealers appeared in the National Daily Quotation Service "pink sheets" for Transnet units.[30/]

251. Between November 18, 1983 and December 23, 1983, First Jersey repurchased approximately 1.7 million Transnet units from its customers: approximately 893,000 at $3.75 per unit, and approximately 838,000 at $4.00 per unit. The price that First Jersey paid to repurchase Transnet units varied between $3.75 and $4.00 from day to day and from customer to customer. (First Jersey Trading Activity Schedule, PX 9; *cf.* Def. Adm. Resp., PX 62 ¶¶ 31(d)-(e).)

252. First Jersey did not disclose to the customers from whom it repurchased the Transnet units the fact that First Jersey intended to split up the units so that the component common stock and warrants would trade separately. (Brennan TT 1407-1409; Dwyer TT 124; *see* PX 98 [Strong 03/16/89] at 106-107.) Indeed, First Jersey continued to buy Transnet "units" from its customers after First Jersey had already split the units. (Barnett TT 5333-5334.)

30/ A complete listing of the "pink sheet" entries for Transnet securities appears in Appendix D hereto.

253. First Jersey caused the Transnet units that it had repurchased from its customers to be split so that the component common stock and warrants became separately transferable. (November 25, 1983 Barnett Letter to The Trust Company of New Jersey, PX 82; Def. Adm. Resp., PX 62 ¶ 31(f).)

254. Net of cancellations, between December 12, 1983 and December 23, 1983, First Jersey sold approximately 1.5 million Transnet Two Year Warrants and Transnet Four Year Warrants to its customers at $1.00 per warrant. (Transnet Markup Schedule, PX 13.)

255. First Jersey did not provide the customers to whom it sold Transnet Two Year Warrants and Transnet Four Year Warrants with the prospectus for the unit offering of November 10, 1983. (*Compare* First Jersey P&S Blotter, PX 172 at page SEC # 00010 *with id.* pages SEC ## 01146, 01469, 01503, 01428, 01354, 01265, 01268, 01604, 01582, 01577, 01561, 01543, 01625.) Nor did First Jersey disclose to those customers the price at which First Jersey had re-acquired the units. (Brennan TT 1518-1522.)

256. Neither Transnet Two Year Warrants nor Transnet Four Year Warrants were quoted on NASDAQ between November 10, 1983 and December 23, 1983. (Transnet Pink Sheets, PX 13.)

257. No broker-dealers appeared in the National Daily Quotation Service "pink sheets" for Transnet Two Year Warrants or Transnet Four Year Warrants between November 10, 1983 and December 23, 1983.[31/]

258. There was no interdealer trading in Transnet Two Year Warrants or Transnet Four Year Warrants between November 16, 1983 and December 23, 1983. (Broker-Dealer Trading Data Schedule, PX 8.)

259. Because there was no interdealer trading in Transnet Two Year Warrants or Transnet Four Year Warrants between November 10, 1983 and December 23, 1983, First Jersey

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[31/] A complete listing of the "pink sheet" entries for Transnet securities appears in Appendix D hereto.

had 100% of the "buy" side of the market and 100% of the "sell" side of the market for those securities during that period. (*Id.*; First Jersey Trading Activity Schedule, PX 9.)

260. First Jersey was not a market maker in Transnet Two Year Warrants or Transnet Four Year Warrants between November 10, 1983 and December 23, 1983. (Haft TT 685-686, 689.)

261. First Jersey dominated and controlled the market for Transnet Two Year Warrants and Transnet Four Year Warrants between November 10, 1983 and December 23, 1983. (Haft TT 685, 689; PX 28.)

262. Because First Jersey was not a market maker in Transnet Two Year Warrants or Transnet Four Year Warrants and because First Jersey in any event dominated and controlled the market for those securities during that period, First Jersey's contemporaneous cost to acquire the Two Year Warrants or Transnet Four Year Warrants that it sold to its customers is the best evidence of the prevailing market price for those securities. (Haft TT 618-620.)

263. First Jersey's contemporaneous cost to acquire the approximately 1.6 million Two Year Warrants or Transnet Four Year Warrants that it sold to its customers between November 10, 1983 and December 23, 1983 did not exceed the $3.75-$4.00 that First Jersey paid to repurchase Transnet units from its customers on and after December 12, 1983, allocated among the common stock and warrants comprising the unit[32/] and giving First Jersey an

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[32/] Between November 12 and December 23, 1983, First Jersey bought 46,675 shares of Transnet common stock in the interdealer market at prices which ranged from $3.25 to $3.50 per share. (Broker Dealer Trading Data Schedule, PX 8.) During this period, First Jersey also purchased 26,680 shares of Transnet common stock from its customers at prices which ranged from $3.00 to $3.625. (First Jersey Trading Activity Schedule, PX 9.)

First Jersey's contemporaneous cost for Transnet warrants as shown in this paragraph was calculated by subtracting from the price that the firm paid to repurchase the units on any given day the *lowest* price that it paid for Transnet

(continued...)

allowance for a 10% markdown. First Jersey's contemporaneous cost to acquire those warrants therefore did not exceed $.396-$.535 per warrant. Nevertheless, First Jersey sold Transnet Two Year Warrants and Transnet Four Year Warrants to customers at $1.00 per warrant on December 12-23, 1983, yielding percentage markups of 87.0% to 152.6%. (Transnet Markup Schedule, PX 13.)

264. Using the method for calculating markups described in Finding 263 above, between December 12, 1983 and December 23, 1983, First Jersey charged its customers $870,426 in markups which exceeded ten percent on those customers' purchases of Transnet Two Year Warrants and Transnet Four Year Warrants, or $711,336 when cancelled transactions are taken into account. (Transnet Markup Schedule, PX 13.)

265. First Jersey's gross profit from its sales of Transnet common stock Transnet Two Year Warrants and Transnet Four Year Warrants to customers between December 12 and December 23, 1984, using First Jersey's actual cost of repurchasing Transnet units as set forth in paragraph 144 above, was $1,009,488. (FJS Disgorgement Calculation, PX 21.)

I. Trading in Securities of Sequential Information Systems, Inc. Between June 13, 1984 and July 6, 1984

266. On June 13, 1984, First Jersey entered into an Underwriting Agreement with Sequential Information Systems, Inc. ("Sequential"). (Sequential Underwriting Agreement, PX 44.)

267. Brennan signed the Sequential underwriting agreement on behalf of First Jersey. (*Id.*)

[W] (...continued)
common stock (whether bought from another broker-dealer or, with an allowance for a 10% markdown, from customers) on that day. (Haft TT 686-687; Lowry TT 435-437.) This method yields the ***highest*** residual cost for the warrants and thereby lowers the markups calculated on First Jersey's sales of the warrants, thereby favoring defendants. (Lowry TT 437-438.)

268. On June 13, 1984, with Brennan's authorization, First Jersey acted as the sole underwriter of 3,000,000 "Units" of Sequential, each unit priced at $2.00 and consisting of fifty shares of common stock, plus an overallotment option of 450,000 additional units. (Sequential Prospectus, PX 4; Def. Adm. Resp., PX 62 ¶¶ 26(b), 32(b).)

269. With respect to the Units, the Sequential prospectus stated that "[t]he shares of Common Stock contained in the Units will not be separately transferable until June 12, 1987 (three years after the date of this Prospectus) or on such earlier date as the Underwriter may determine." (Sequential Prospectus, PX 4 at 1.)

270. First Jersey sold the Sequential units to customers of its branch offices. (Def. Adm. Resp., PX 62 P 32(c).)

271. No Sequential security was quoted on NASDAQ between June 13, 1984 and July 6, 1984. (Sequential Pink Sheets, PX 26.)

272. Between June 13, 1984 and July 6, 1984, between one and two broker-dealers, neither of which was First Jersey, appeared (without price quotations) in the National Daily Quotation Service "pink sheets" for Sequential units.[33/] Neither of those broker-dealers had any purchases or sales of Sequential units during that period. (Broker-Dealer Trading Data Schedule, PX 8.)

273. Between June 14, 1984 and July 3, 1984, First Jersey repurchased 2,934,725 Sequential units from its customers at prices ranging from $2.25 to $3.00 per unit, as follows:

Date	Price	# of Units Repurchased
June 14	$2.25	2,297,825[34/]

[33/] A complete listing of the "pink sheet" entries for Sequential securities (with price quotations, if any, as shown) appears in Appendix E hereto.

[34/] For trade date June 14, First Jersey's records show purchases of 2,973,175 units; the number shown in the table is net of a 675,350-unit cancellation that was physically input after June 14, but for the same settlement day as June 14 trades.

June 15	$2.156	125,000
	$2.25	246,525
June 18	$2.25	77,725[35/]
	$2.344	125,000
June 19	$2.25	7,425
	$2.25	3,125
	$2.75	2,375[36/]
	$3.00	14,250
June 20	$3.00	17,650
June 21	$3.00	4,725[37/]
June 22	$2.25	500
	$3.00	5,500
June 25	$2.25	500
	$3.00	2,500
June 26	$3.00	850
June 27	$3.00	2,200
June 28	$3.00	500

[35/] For trade date June 18, First Jersey's records show purchases of 152,250 units; the number shown in the table is net of a 75,525-unit cancellation that was physically input after June 18, but for the same settlement day as June 18 trades.

[36/] For trade date June 19, First Jersey's records show purchases of 4,750 units at $2.75; the number shown in the table is net of a 2,375-unit cancellation that was physically input after June 19, but for the same settlement day as June 19 trades.

[37/] For trade date June 21, First Jersey's records show purchases of 9,450 units at $2.75; the number shown in the table is net of a 4,725-unit cancellation that was physically input after June 21, but for the same settlement day as June 21 trades.

June 29	$3.00	300
July 3	$3.00	250

(First Jersey Trading Activity Schedule, PX 9; *cf.* Def. Adm. Resp., PX 62 ¶¶ 32(d)-(e).)

274. First Jersey did not disclose to the customers from whom it repurchased the Sequential units the fact that First Jersey intended to split up the units immediately so that the component common stock and warrants would trade separately. (*See* Brennan TT 1407-1409; *see* PX 98 [Strong 03/16/89] at 106-107.)

275. First Jersey caused the Sequential units that it had repurchased from its customers to be split so that the component shares of common stock became separately transferable. (June 29, 1984 Barnett Letter to Sequential Information Systems, Inc., PX 83; Def. Adm. Resp., PX 62 ¶ 32(f).)

276. Net of cancellations, between June 19, 1984 and July 6, 1984, First Jersey sold approximately 153,000,000 shares of Sequential common stock to its customers at $.125 per share. (Sequential Markup Schedule, PX 14.)

277. First Jersey did not provide the customers to whom it sold Sequential common stock with the prospectus for the unit offering of June 13, 1984. (*Compare* First Jersey P&S Blotter, PX 173 at page SEC # 01698 *with id.* pages SEC # 01865, 02906, 02721, 02241, 02013, 02980, 02999, 03135, 03539, 03497, 03674, 03737, 03999, 04041; Dwyer TT 117-121.) Nor did First Jersey disclose to those customers the price at which First Jersey had re-acquired the units. (Brennan TT 1518-1522.)

278. Between June 13, 1984 and July 6, 1984, between five and eight broker-dealers (one to two of whom provided quotations on each day) appeared in the National Daily Quotation Service "pink sheets" for Sequential common stock. First Jersey

did not appear in the "pink sheets" for Sequential common stock at any time between June 13, 1984 and July 6, 1984.[38]

279. Excluding transactions involving First Jersey, broker-dealers listed in the "pink sheets" purchased 970,825 shares of Sequential common and sold 1,660,200 shares of Sequential common between June 10 and July 6, 1984. During this period, First Jersey bought no shares of Sequential common stock and sold 37,000 shares of Sequential common stock in the interdealer market. Prices in the interdealer market ranged from $.02 to $.188 per share. (First Jersey/Broker Dealer Volume Summary for Sequential, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

280. When First Jersey's retail transactions are combined with the interdealer trading, First Jersey had 2.7% of the "buy" side of the market for Sequential common stock and 99% of the "sell" side of the market for Sequential common stock between June 10, 1984 and July 6, 1984. (First Jersey/Broker Dealer Volume Summary for Sequential, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

281. First Jersey was not a market maker in Sequential common stock between June 10, 1984 and July 6, 1984. (Haft TT 692-693.)

282. First Jersey dominated and controlled the market for Sequential common stock between June 10, 1984 and July 6, 1984. (Haft TT 692-693; PX 28.)

283. Because First Jersey was not a market maker in Sequential common stock and in any event dominated and controlled the market for Sequential common stock, First Jersey's contemporaneous cost to acquire the Sequential common stock that it sold to its customers is the best evidence of the prevailing market price for that stock. (Haft TT 618-620.)

284. First Jersey's contemporaneous cost to acquire the approximately 154,000,000 shares of Sequential common stock that it sold to its customers between June 19 and July 6, 1984 did not

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[38] A complete listing of the "pink sheet" entries for Sequential securities (with price quotations, if any, as shown) appears in Appendix E hereto.

exceed the $3.00 that First Jersey paid to repurchase Sequential units from its customers on and after June 19, 1984, allocated among the 50 common shares comprising the unit and giving First Jersey an allowance for a 10% markdown. First Jersey's contemporaneous cost to acquire that stock therefore did not exceed $.067 per share. Nevertheless, First Jersey sold Sequential common stock to its customers for $.125 per share on June 19-July 6, 1984, yielding percentage markups of 87.5%. (Sequential Markup Schedule, PX 14.)

285. Using the method for calculating markups described in Finding 284 above, between June 19, 1984 and July 6, 1984, First Jersey charged its customers $10,613,001 in markups which exceeded ten percent on those customers' purchases of Sequential common stock, or $8,972,740 when cancelled transactions are taken into account. (Sequential Markup Schedule, PX 14.)

286. First Jersey's gross profit from its sales of Sequential common stock to customers between June 14 and July 6, 1984, using First Jersey's actual cost of repurchasing Sequential units as set forth in Finding 273 above, was $12,111,384. (FJS Disgorgement Schedule, PX 21.)

J. Trading in Securities of QT & T, Inc. Between January 28, 1985 and February 15, 1985

291. Quasar Microsystems, Inc. changed its corporate name to QT&T, Inc. ("QT&T") in July 1984. (QT&T Prospectus, PX 5 at 2.)

292. On January 28, 1985, First Jersey entered into an Underwriting Agreement with QT&T. (QT&T Underwriting Agreement, PX 45.)

293. Brennan signed the QT&T underwriting agreement on behalf of First Jersey. (*Id.*)

294. On January 28, 1985, with Brennan's authorization, First Jersey acted as the sole underwriter of 2,000,000 "Units" of QT&T, each unit priced at $2.75 and consisting of two shares of common stock and one warrant exercisable for $2.00 per share through February 16, 1987 and for $3.00 per share through February 14, 1990, plus an overallotment option of 300,000

additional units. (QT&T Prospectus, PX 5; Def. Adm. Resp., PX 62 ¶¶ 26(b), 33(b).)

295. With respect to the Units, the QT&T prospectus stated that "[t]he Unit Warrants and shares of Common Stock will not be separately transferable or the Unit Warrants exercisable until July 29, 1985 (182 days after the date of this Prospectus) or such earlier date as the Underwriter may determine." (QT&T Prospectus, PX 5 at 1.)

296. First Jersey sold the QT&T units to customers of its branch offices. (Def. Adm. Resp., PX 62 ¶ 33(c).)

297. The QT&T offering was oversold in that First Jersey sold approximately 5,970,000 units to its customers, compared to the 2,300,000 units that were registered. (First Jersey Trading Activity Schedule, PX 9; Outline of FJ Transactions, PX 20.)

298. QT&T Units were not quoted on NASDAQ between January 28, 1985 and February 15, 1985. (QT&T Pink Sheets, PX 27.)

299. One broker-dealer, Sherwood Securities Corporation, appeared without quotations in the National Daily Quotation Service "pink sheets" for QT&T units between January 28, 1985 and February 15, 1985.[39] That broker-dealer reported no purchases or sales of QT&T units during that period. (Broker-Dealer Trading Activity Schedule, PX 8.)

300. Between January 29 and February 15, 1985, First Jersey repurchased approximately 3.6 million QT&T Units from its customers at $3.00 per unit. (First Jersey Trading Activity Schedule, PX 15.)

301. First Jersey did not disclose to the customers from whom it repurchased the QT&T units the fact that First Jersey intended to split up the units immediately so that the component

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[39] A complete listing of the "pink sheet" entries for QT&T securities appears in Appendix F hereto.

common stock and warrants would trade separately. (*See* Brennan TT 1407-1409; *see* PX 98 [Strong 03/16/89] at 106-107.)

302. First Jersey caused the QT&T units that it had repurchased from its customers to be split so that the component common stock and warrants became separately transferable. (February 14, 1985 Barnett Letter to Roger Bernhammer, PX 84; Def. Adm. Resp., PX 62 ¶ 33(f).)

303. Net of cancellations, between January 29 and February 15, 1985 First Jersey sold 1,163,755 shares of QT&T common stock to its customers at $2.00 per share. 1,121,730, or over 96%, of those shares were sold on two trading days, January 30 and 31. (QT&T Markup Schedule, PX 15.)

304. First Jersey did not provide the customers to whom it sold QT&T common stock with the prospectus for the unit offering of January 13, 1985. (*Compare* First Jersey P&S Blotter, PX 174 at page SEC # 05077 *with id.* pages SEC # 04802, 04602, 05363, 05335, 05320, 05304, 05290, 05497, 05483, 05471, 05463, 05524.) Nor did First Jersey disclose to those customers the price at which First Jersey had re-acquired the units. (Brennan TT 1518-1522.)

305. Between January 29 and February 15, 1985, First Jersey purchased 47,170 shares of QT&T common stock from its customers. (First Jersey Trading Activity Schedule, PX 9.)

306. QT&T common stock was quoted on NASDAQ between January 28, 1985 and February 15, 1985. Between January 28 and February 15, the information reported on NASDAQ concerning QT&T common stock was as follows:

Previous Week

Date	Volume	High Bid	Low Bid	Bid	Asked
Jan. 28	2378	1 ½	1 ½	1 ½	1 9/16
Jan. 29	2378	1 ½	1 ½	1 ½	1 9/16
Jan. 30	2378	1 ½	1 ½	1 ½	1 9/16

Previous Week

Date	Volume	High Bid	Low Bid	Bid	Asked
Jan. 31	2378	1 ½	1 ½	1 ⅝	1 ⅞
Feb. 1	2378	1 ½	1 ½	1 ⅝	1 ⅞
Feb. 4	1685	1 ⅝	1 ½	1 ⅝	1 ¾
Feb. 5	1685	1 ⅝	1 ½	1 ⅝	1 ¾
Feb. 6	1685	1 ⅝	1 ½	1 ⅝	1 ¾
Feb. 7	1685	1 ⅝	1 ½	1 ⅝	1 ¾
Feb. 8	1685	1 ⅝	1 ½	1 ⅝	1 ¾
Feb. 11	2261	1 ⅝	1 ⅝	1 ⅝	1 ¾
Feb. 12	2261	1 ⅝	1 ⅝	1 ⅝	1 ¾
Feb. 13	2261	1 ⅝	1 ⅝	1 ½	1 ⅝
Feb. 14	2261	1 ⅝	1 ⅝	1 ½	1 ¾
Feb. 15	2261	1 ⅝	1 ⅝	1 ½	1 ¾

(QT&T Pink Sheets, PX 27.)

307. On each day between January 28, 1985 and February 15, 1985, from seven to ten broker-dealers appeared (without price quotations) in the National Daily Quotation Service "pink sheets" for QT&T common stock. First Jersey did not appear in the "pink sheets" for QT&T common at any time during that period.[40/]

308. Excluding transactions involving First Jersey, broker-dealers listed in the "pink sheets" purchased 160,683 shares of QT&T common and sold 67,330 shares of QT&T common

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[40/] A complete listing of the "pink sheet" entries for QT&T securities appears in Appendix F hereto.

between January 29 and February 15, 1985. During this period, First Jersey bought 455,300 shares of QT&T common stock and sold 42,300 shares of QT&T common stock in the interdealer market. Prices in the interdealer market ranged from $1.25 to $1.875 per share. (First Jersey/Broker Dealer Volume Summaries, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

309. When First Jersey's retail transactions are combined with the interdealer trading, First Jersey had 75.8% of the "buy" side of the market for QT&T common stock and 94.5% of the "sell" side of the market for QT&T common stock between January 29, 1985 and February 15, 1985. (First Jersey/Broker Dealer Volume Summaries, PX 18; Broker Dealer Trading Data Schedule, PX 8.)

310. First Jersey was not a market maker in QT&T common stock between January 29 and February 15, 1985. (Haft TT 696.)

311. First Jersey dominated and controlled the market for QT&T common stock between January 29 and February 15, 1985. (Haft TT 696; PX 28.)

312. Because First Jersey was not a market maker in QT&T common stock and in any event dominated and controlled the market for QT&T common stock, First Jersey's contemporaneous cost to acquire the QT&T common stock that it sold to its customers is the best evidence of the prevailing market price for that stock. (Haft TT 618-620.)

313. First Jersey's contemporaneous cost to acquire the approximately 1.1 million shares of QT&T common stock that it sold to its customers between January 29 and February 4, 1985 did not exceed the $3.00 that First Jersey paid to repurchase QT&T units from its customers on and before February 4, 1985, allocated between the 2 common shares comprising the unit[41/] and giving

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[41/] Because First Jersey did not retail the warrant contained in the QT&T Unit during this period, the calculation described in this paragraph gives no value to the warrant. This method yields the *highest* residual cost for the common stock and thereby lowers the markup calculated on First Jersey's sales of that common stock.

(continued...)

First Jersey an allowance for a 10% markdown (Haft TT 695.) First Jersey's contemporaneous cost to acquire those shares therefore did not exceed $1.667 per share. Nevertheless, First Jersey sold QT&T common stock to its customers for $2.00 per share on January 29-February 4, 1985, yielding percentage markups of -6.2% (one transaction) and 20.0% (all other transactions). (QT&T Markup Schedule, PX 15.)

314. First Jersey's contemporaneous cost to acquire the approximately 10,000 shares of QT&T common stock that it sold to its customers between February 5 and February 15, 1985 did not exceed the $1.50-$1.688 that First Jersey paid to acquire QT&T common stock from broker-dealers on and after February 5, 1985. Nevertheless, First Jersey sold QT&T common stock to its customers at $2.00 per share between February 5, 1985 and February 15, 1985, yielding percentage markups varying from 18.5% to 33.3%. (QT&T Markup Schedule, PX 15.)

315. Using the methods for calculating markups described in Findings 313 and 314 above, between January 29, 1985 and February 15, 1985, First Jersey charged its customers $431,932 in markups which exceeded ten percent on those customers' purchases of QT&T common stock, or $388,178 when cancelled transactions are taken into account. (QT&T Markup Schedule, PX 15.)

316. First Jersey's gross profit from its sales of QT&T common stock to customers between January 29, 1985 and February 15, 1985, using First Jersey's actual cost of repurchasing QT&T units as set forth in Finding 300 above, was $581,659. (FJS Disgorgement Schedule, PX 21.)

K. First Jersey's Activities in the Securities Business Since January 31, 1995

328. On January 30, 1987, First Jersey sold the bulk of its retail offices to Sherwood Capital Corporation, but thereafter First Jersey continued to be a broker-dealer registered with the

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41/ (...continued)
(Haft TT 695-696; Lowry TT 441.)

Commission pursuant to Section 15 of the Exchange Act. (PX 175; Def. Adm. Resp. ¶ 1, PX 62, Tr. 1908.) First Jersey and Brennan continue to maintain offices at 50 Broadway in New York City. (Brennan TT 1553.)

329. In April 1987 Roger Barnett, formerly the secretary-treasurer and chief financial officer of First Jersey, became President of First Jersey. (CCC Franchising Corp. Notice of Annual Meeting of Stockholders, November 17, 1992, PX 65 at Bates No. 000410.)

330. Since January 31, 1987, First Jersey has continued to buy and sell securities for its own account, as shown by First Jersey's reported results from operations for the following fiscal years ended November 30:

1987[42/]

REVENUE		
Commissions	$ 364,050	
Net Realized Dealer Inventory and Investment Gains	2,091,682	
Interest	1,566,812	
Other Income	165,749	
TOTAL REVENUE		$4,188,293
EXPENSES		
Unrealized Dealer and Investment Losses	$2,936,229	
Employee Compensation and Benefits	2,682,947	
Commissions	4,149,631	
Clearing Charges	102,641	
Communications	360,126	
Occupancy and Equipment Rental	328,482	

42/ 1987 results of operations do not include net income from discontinued operations of $13,896,287.

Interest	231,282	
Taxes Other than Income Taxes	227,083	
Other Operating Expenses	9,792,260	
TOTAL EXPENSES		$20,810,681

1988

REVENUE		
Commissions	65,490	
Net Realized Dealer Inventory and Investment Gains	6,750,725	
Interest	433,173	
Other Income	383	
TOTAL REVENUE		$7,249,771
EXPENSES		
Unrealized Dealer and Investment Losses	$498,025	
Employee Compensation and Benefits	2,431,454	
Commissions	943,733	
Clearing Charges	95,520	
Communications	157,102	
Occupancy and Equipment Rental	48,930	
Interest	1,279,522	
Taxes Other than Income Taxes	191,187	

Other Operating Expenses	6,299,127	
TOTAL EXPENSES		$11,944,600

1989

REVENUE		
Net Realized Dealer Inventory and Investment Gains	7,352,322	
Other Income	114,659	
TOTAL REVENUE		$7,466,981
EXPENSES		
Employee Compensation and Benefits	2,264,602	
Commissions	5,174,938	
Clearing Charges	40,058	
Communications	113,274	
Occupancy and Equipment Rental	35,523	
Interest	58,368	
Taxes Other than Income Taxes	161,720	
Other Operating Expenses	7,465,617	
TOTAL EXPENSES		$15,314,100

1990

REVENUE		
Net Realized Dealer Inventory and Investment Gains	$4,865,312	
Other Income	164,459	
TOTAL REVENUE		$5,029,771
EXPENSES		
Employee Compensation and Benefits Commissions	$2,544,044	
Commissions	1,723,757	
Communications	76,916	
Occupancy and Equipment Rental	38,097	
Taxes Other than Income Taxes	121,946	
Other Operating Expenses	5,527,874	
TOTAL EXPENSES		$10,032,634

1991

REVENUE		
Net Realized Dealer Inventory and Investment Gains	$9,714,871	
Other Income	121,659	
TOTAL REVENUE		$9,836,530

EXPENSES		
Employee Compensation and Benefits	$2,438,868	
Commissions	5,968,982	
Communications	75,615	
Occupancy and Equipment Rental	33,870	
Taxes Other than Income Taxes	111,970	
Other Operating Expenses	6,842,058	
TOTAL EXPENSES		$15,471,363

1992

REVENUE		
Net Realized Dealer Inventory and Investment Gains	$132,615	
Other Income	39,033	
TOTAL REVENUE		$171,648
EXPENSES		
Employee Compensation and Benefits Commissions	$1,405,365	
Commissions	37,500	
Communications	61,550	
Occupancy and Equipment Rental	33,813	
Taxes Other than Income Taxes	95,508	
Other Operating Expenses	2,915,023	

TOTAL EXPENSES		$4,548,759

1993

REVENUE

Net Realized Dealer Inventory and Investment Gains	$170,247	
Other Income	4,370	
TOTAL REVENUE		$174,617

EXPENSES

Employee Compensation and Benefits Commissions	$43,130	
Communications	45,000	
Occupancy and Equipment Rental	5,105	
Other Operating Expenses	12,824	
TOTAL EXPENSES		$108,079

(First Jersey Securities, Inc. Form X-17A-5 Filings for 1987, 1988, 1989, 1990, 1991, 1992, and 1993, PXs 49-55.)

331. From at least February 1990 through September 1990, First Jersey maintained a securities trading account at PaineWebber, Inc., in which it held securities issued by the following companies:

Advanced Energy Concepts	Jays Industries Inc.
Advent Corp.	Jojoba Horizons Inc.
Allison Industries Ltd.	Lake City Mines Inc.
Alpine Gold & Silver Co.	Landmark Oil & Gas
American Artists Ltd.	Levin Int'l Corp.

American Capital Group Inc.

American Educational Television Network Ltd.

American Heliothermal Corp.

American National Hydrocarbon

American National Hydrocarbon Inc.

American Surgical Laser Inc.

Apogee Robotics Inc.

Aqua Sol Inc.

Aquaculture Production Technology Ltd.

ARP Instruments Inc.

Binary Systems Inc.

Biosynergy Inc.

Brady Energy Corp.

Bullion Monarch Co.

CCC Franchising

C S Primo Co.

Cadema Corp.

Camptown Industries Inc.

Capital Facilities Corp.

Chadron Energy Corp.

Chefs International Inc.

Livestock Finl Corp. Colo

Living Industries

Logos Corp.

LS Cap Corp.

LSI Corp.

Lyric Energy Inc.

Magna Technologies Inc.

McCoy Industries Inc.

Medivix Inc.

Metals Technology Intl

Mid American Petroleum

Midwestern Resources Inc.

Miner Industries Inc.

Monetary Res. Inc.

ND Resources

Neog Holding Corp.

Nova Resources Corp.

Nutek Corp.

Oil Int'l Ltd.

Oil Producers Equipment Corp.

OMX Corp.

Chiropractic 21 Int'l Inc.

Claires Stores Inc.

Cleve Calendering & Coating Corp.

Computers for Less Inc.

Cont'l Energy Corp. Colo

Crescent Oil & Gas

Cytox Corp.

Data Access Systems Inc.

Davin Computer Corp.

Denning Mobile Robot Corp.

Denver Wstn Petroleum

Destron Inc.

DOL Resources Inc.

Elan Air Corp.

Electrograph Sys Inc.

Electronic Publishing

Technology

Empire Apparel Stores Inc.

Encore Industries Inc.

Energy Productions Co.

ESI Industries Corp.

Pac Int'l Svcs. Corp.

Pac Western Industries Corp.

Peoples Restaurants Inc.

Petro Quest Inc.

Petromax Energy Corp.

Premier Energy Cop.

Pro Scan Inc.

QT&T Inc.

Rampart General Inc.

Record Retention & Retrieval

Regent Air Corp.

Reprotech Corp.

Research Fdg Inc.

Robot Defense Sys Inc.

Rooney Pace Group Inc.

SCN Ltd.

Seahawk Capital Corp.

Sequential Infor Sys

SL Resources Inc. Prods

Sovereign Chem & Pete Prods

Stansbury Mining Corp.

EXAR Communication Inc.

First Coinvestors

GBC Closed Circuit TV

Geosearch Inc.

Gibson Cryogenics Inc.

Good Software Corp.

Great American Recreation Inc.

Greer Software Associates Inc.

Holland Industries

Hydro Power Development Inc.

IIS Ltd.

Info Data Inc.

Intercare Inc.

Int'l Metals & Petroleum Corp.

Int'l Stretch Products Inc.

Int'l Thoroughbred Breeders Inc.

Starcom Inc.

Stevia Inc.

Stony Point Recreation Corp.

Summit Petroleum Corp.

Syn Trek Inc.

Taurus Petroleum Inc.

Tevere Inc.

Texas Petroleum Corp. Colo

Thermatron Inc.

Tide West Oil Co.

Trans Atlantic Games Inc.

Trans Atlantic Video

Trans Sys Svcs.

Universal Container Corp.

Universal Services Group

Untd Solar Associates

Utility Verification Corp.

Vernon Valley Recreation Assn Inc.

(PaineWebber Account Statements, PX 181 at Bates Nos. 000070-000115.)

332. On January 17, 1991, First Jersey extended a $400,000 loan to Franklin N. Wolf, the President of the brokerage firm F.N. Wolf & Co. (PX 276; Barnett TT 5435-5436.)

333. On September 3, 1991, First Jersey paid $4,300,000 to Hibbard Brown & Co. for the purchase of securities by Robert Brennan. (PX 278; Barnett TT 5576- 5577.)

334. On September 16, 1991, First Jersey extended a $300,000 loan to Hibbard Brown & Co. (PX 279; Barnett TT 5577.)

L. Brennan's Activities in the Securities Business Since January 31, 1987

335. Since January 31, 1987, Brennan has continued to own 100 percent of the issued and outstanding stock of First Jersey. (Def. Adm. Resp., ¶ 16, PX 62, Tr. 1912-13.)

336. Since January 31, 1987, Brennan has continued to be a director of First Jersey. (CCC Franchising Corp. Notice of Annual Meeting of Stockholders, November 17, 1992, PX 65 at Bates No. 000410.)

337. Until October 19, 1993, Brennan continued to be registered with the NASD as a person associated with First Jersey. (November 4, 1993 Letter from Barnett to NASD enclosing Form U-5 for Brennan, PX 57.)

338. Brennan is the sole shareholder, a director, and President/Treasurer, and Barnett is Vice-President/Secretary, of Austin Bernet, Inc. ("Austin Bernet"), a New Jersey corporation with its principal place of business at 340 North Avenue, Cranford, New Jersey. (Brennan TT 1568-1569; PX 86 [Brennan 03/04/92] at 562; Account Opening Form for Austin Bernet at PaineWebber, PX 181 at Bates No. 000129.) Brennan and Barnett are the sole officers and directors and make all decisions on behalf of Austin Bernet. (Brennan TT 1569.)

339. In 1988, Hibbard Brown & Co., a broker-dealer, purchased from Sherwood Securities the retail offices that First Jersey had sold to Sherwood in 1987, and also assumed the obligation to maintain First Jersey's and Brennan's office space at 50 Broadway. (Brennan TT 1593, 1629.) Austin Bernet, with Brennan's approval, has made overnight broker loans to Hibbard

Brown (Brennan TT 1632-1633), and has also extended longer-term loans to Hibbard Brown for as much as $4.5 million (PXs 280-283; Barnett TT 5577-5578). In 1988, Brennan initially discussed with Peter Hibbard, a principal of Hibbard Brown, a possible investment by Brennan in Hibbard Brown. (Brennan TT 1593-1594.) That investment was not made; however, in mid-1988, Brennan personally lent $5-$6 million to George Stamos for the purpose of assisting in Stamos' investment in Hibbard Brown. (Brennan TT 1598-1600, 1610; PX 86 [Brennan 11/06/91] at 300-301, 309.) Stamos, who had represented Brennan in various projects, had been one of the first investors in First Jersey in the 1970s. (Brennan TT 1600.) Several months thereafter Mickey Hart, another associate of Brennan, assumed the equity portion of Stamos' investment in Hibbard Brown as well as approximately $2 million of Stamos' debt to Brennan. (Brennan TT 1605, 1633-1636.)

340. Brennan, through Austin Bernet, also provided more than $200,000 in collateral to Leonard Greer, who had handled the First Jersey account at PaineWebber (see Finding 331 above), at a time when Greer was seeking to purchase L.C. Wegard & Co., another securities brokerage firm (Brennan TT 1569-1574, 1582-1585; PX 86 [Brennan 03/04/92] at 563-566.) Companies in which Brennan has an interest have lent money, ranging from a few hundred thousand dollars to $1-$2 million, to L.C. Wegard since Greer took the firm over. (Brennan TT 1586-1587.) On August 20, 1991, Austin Bernet sold Leonard Greer 350,000 common stock purchase warrants of Site-Based Media, Inc. in exchange for a $400,000 promissory note from Mr. Greer. (PXs 285, 287; Barnett TT 5447-5448). On that same day, Austin Bernet also sold Mr. Greer 300,000 shares of Nacoma Consolidated Industries, Inc. in exchange for a $600,000 promissory note from Mr. Greer. (PXs 286, 288; Barnett TT 5447-5448.) On November 25, 1991, Austin Bernet repurchased the 350,000 Site-Based warrants from Mr. Greer for $2,100,000 and Mr. Greer repaid both of his August 1991 promissory notes. (PXs 289-291; Barnett TT 5448-5449.) On July 26, 1993, Austin Bernet sold L.C. Wegard 100,000 shares of Sanyo Industries, Inc. for $300,000 plus 200,000 warrants of U.S. Transportation Systems, Inc. and 500,000 common shares of Thermodynetics, Inc.

(PX 295; Barnett TT 5450-5452.) Brennan closed his July 26, 1993 letter to L.C. Wegard confirming that transaction by stating:

> As we discussed, we would be happy to entertain "size" bids on Creative Resources, Poseidon Pools, Dreamcar Holdings, News Communications, Stateswest Airlines and International Microelectronic Products. These securities are available subject to prior sale. Please let us know if you need any additional information about any of these companies. (PX 295.)

341. Brennan is the controlling stockholder and a director of FJS Properties, Inc., which is the managing general partner of FJS Properties Fund I.L.P., a publicly-owned entity. (CCC Franchising Corp. Notice of Annual Meeting, PX 65 at Bates No. 000410; Brennan TT 1785-1786.)

342. Brennan is the owner, president, and a director of Due Process Stable. (Brennan TT 1785; PX 86 [Brennan 05/22/91] at 7.) In September 1991, Due Process Stable sold Hibbard Brown 22,000 options entitling the firm to buy 2.2 million shares of Site-Based Media, Inc. (Brennan TT 1620-1621.) In October, Due Process Stable sold Hibbard Brown additional options entitling the firm to buy 4.4 million Site-Based warrants. (Brennan TT 1621.) In December 1991 Austin Bernet sold Hibbard Brown 26,000 options to buy another 2.6 million Site-Based warrants. (Brennan TT 1622, 1630-3.)

343. Brennan is the Chief Executive Officer and sole shareholder of Hartley Bush Financial Corp. ("Hartley Bush"), a New Jersey corporation with its principal place of business at 340 North Avenue, Cranford, New Jersey. (Schedule 13D for CCC Franchising Corp., filed Feb. 24, 1992, PX 79 at Bates No. 000448; Brennan TT 1782-1783.)

344. Brennan is Chairman of the Board of International Thoroughbred Breeders, Inc. ("ITB"), a publicly-held corporation which trades on the American Stock Exchange. (PX 86 [Brennan 05/24/91] at 151-153, [Brennan 11/06/91] at 385; Brennan TT 1784.) As of December 30, 1992 Brennan was Chief Executive Officer as well as Chairman of ITB, and owned 4.3 million shares

of the company's stock. (Form 4 filed by Brennan on January 11, 1993, PX 56 at Bates No. 000192; *see also* Brennan TT 1784.)

345. On June 19, 1987, Brennan acquired 16,899,000 shares or 46.1% of the common stock of Chefs International, Inc., a publicly-owned company in whose securities First Jersey made a market. (Schedule 13D filed by Robert E. Brennan, PX 58 at Bates Nos. 000372, 000377-000378.) As of June 29, 1990, Brennan owned 17,399,000 shares of Chefs International common stock. (Form 3 filed by Robert E. Brennan, PX 68 at Bates No. 000164.) Brennan is the largest shareholder of Chefs International. (Brennan TT 1657.) As of August, 1993, Brennan was effectively able to elect all of Chefs' directors and control its affairs. (Form SB-2 filed by Chefs International, PX 69 at 11.) In the summer of 1993, Brennan recommended that Chefs make a unit offering and assisted Chefs in finding an underwriter. (Brennan TT 1668-1669.)

346. On February 19, 1991, Brennan acquired 16,000,000 shares of the common stock of CCC Franchising Corporation. (Form 3 filed by Robert E. Brennan, PX 60 at Bates No. 000158.) Brennan thus became the majority shareholder of CCC Franchising. (PX 86 [Brennan 05/22/91] at 6-8; Brown TT 2023-2024; compare Brennan TT 1645-1646.) CCC Franchising is a publicly-held company that trades on NASDAQ. (Brennan TT 1641.) The President of CCC Franchising is Andrew C. Alson, who is also the President of FJS Properties, Inc. (see Finding 341 above). (CCC Franchising Notice of Annual Meeting, PX 65 at Bates Nos. 000409-000410.) Brennan has personally guaranteed obligations of CCC Franchising, including its notes for a corporate acquisition. (Brennan TT 1648.) Brennan sold 2,000,000 of his CCC common shares in May 1991 (Form 4 filed by Robert E. Brennan, PX 186 at Bates No. 000156), 2,000,000 more in December 1991 (Form 4 filed by Robert E. Brennan, PX 185 at Bates No. 000154), 400,000 more in April 1992 (Form 4 filed by Robert E. Brennan, PX 63 at Bates No. 000150), and 300,000 more in September 1992 (Form 4 filed by Robert E. Brennan, PX 182 at Bates No. 000144). In February 1992 Brennan, through Hartley Bush, received 5,000,000 warrants to purchase common stock of CCC Franchising as consideration for the posting, by a

corporation wholly owned by Brennan, of collateral for a $30,000,000 bank loan to a wholly-owned subsidiary of CCC. (Form 4 filed by Brennan, PX 184 at Bates No. 000153, and Form 4 filed by Hartley Bush, PX 188 at Bates No. 000163.) In May 1992, Hartley Bush distributed those 5,000,000 warrants to Brennan. (Form 4 filed by Brennan, PX 183 at Bates No. 000149, and Form 4 filed by Hartley Bush, PX 187 at Bates No. 000161.) In June 1992 Brennan received an additional 2,000,000 warrants to purchase CCC Franchising common stock as consideration for the delivery of Brennan's guaranty with respect to a $20,000,000 obligation of CCC. (Form 4 filed by Brennan, PX 67 at Bates No. 000147.) As of October 1992, Brennan owned 46% of the common stock of CCC Franchising. (CCC Franchising Notice of Annual Meeting, PX 65 at Bates No. 000408; Brennan TT 1646.) In January 1993 Brennan participated in a public offering by CCC Franchising of 7.5 million shares, underwritten by F.N. Wolf & Co. (Brennan TT 1650-1651.) Brennan is still a major shareholder of CCC Franchising today. (Brennan TT 1646.)

347. During 1991, CCC Franchising loaned money to Digital Products Corp. (Brennan TT 1652.) In June 1992, CCC Franchising, which had owned various securities of Digital Products since January 1991, sold 1,100,000 warrants to purchase Digital Products common stock at $1.25 per share, plus 1,000,000 shares of Digital Products common stock, to Digital Products for $10,000,000 plus 2,000,000 warrants to purchase Digital Products common stock at $10.00 per share. (Form 4 filed by CCC Franchising, PX 190 at Bates No. 000169; Form 4 filed by CCC Franchising, PX 196 at Bates No. 000180.)

348. Brennan played a significant role in CCC Franchising's acquisition of Primedex Corporation, including introducing two of Primedex's officers to CCC Franchising, performing some of the "due diligence" for the acquisition, and putting up a substantial percentage of the purchase price. (Brennan TT 1648-1652.) On November 20, 1992, CCC Franchising changed its name to Primedex Health Systems, Inc. ("Primedex"). (Schedule 13D filed by Primedex on March 11, 1993, PX 206 at Bates No. 000210.) Roger Barnett was installed as an officer of Primedex. (Brennan TT 1652.) As of May 28, 1993, Primedex

was the majority shareholder of Immunotherapeutics, Inc., which is a publicly-held company that trades on the over-the-counter market. (Schedule 13D filed by Primedex on May 28, 1993, PX 205 at Bates No. 000207.)

349. On October 25, 1991, Austin Bernet purchased 314,325 shares, or 9.9%, of the common stock of First State Financial Services, Inc. (Schedule 13D filed by Austin Bernet, PX 239; *see* Brennan TT 1783-1784.)

350. From at least February 23, 1991 until at least May 29, 1992, Austin Bernet maintained a securities trading account at Dominick & Dominick, a registered broker-dealer, in which Austin Bernet bought and sold securities of Future Funding Corporation, Digital Products Corporation, Great American Recreation Inc., Site-Based Media Inc., SL Resources, Nacoma Consolidated Industries Inc., Officeland Inc., Unified Capital, and Treats International Enterprises. (Dominick & Dominick Account Statements, PX 181 at Bates Nos. 000036-000068.) From at least January 28, 1991 through at least September 27, 1991, Austin Bernet maintained a securities trading account at Adler, Coleman & Co., Inc., a broker-dealer, in which Austin Bernet purchased and sold securities of Future Funding Corp, Nacoma Consolidated Industries, PDK Labs, Inc., and Site-Based Media Inc. (Adler, Coleman Account Statements, PX 230 at Bates Nos. 0000591-597.)

351. As of March 6, 1992, Brennan owned 2,458,663 shares of the common stock of Bally Manufacturing Corporation, a publicly-owned company. (Schedule 13D regarding Bally, PX 59 at Bates No. 000479.)

352. On May 29, 1992, the Commission issued an order suspending trading in the securities of Treats International Enterprises, Inc. because of a lack of current and accurate information regarding the identity of persons having undisclosed control of the company and beneficial ownership of the company's securities. (PX 47; Brennan TT 1682-1683.) Thereafter, Treats filed a Form 10-K which disclosed that Austin Bernet and three Brennan family trusts owned, in the aggregate, 96% of 96Treats's Class A warrants, 96% of Treats' Class B warrants, and 6.67% of Treats' common stock. (PX 61 at Bates No. 000818; Brennan TT

1685-1687.) During 1992 or early 1993 Austin Bernet loaned Treats approximately $1 million. (Brennan TT 1697.) As of June 30, 1993, Austin Bernet and the Brennan family trusts collectively owned 4,656,998 shares, or 23.95%, of Treats' common stock. (PX 61A at Bates No. 000897; Brennan TT 1695-1696.) On November 6, 1992, the New Jersey Bureau of Securities withdrew the exemption under which Treats securities were sold in that state, on the ground, among others, that Brennan's interest in the company had not been disclosed. (PX 232; Brennan TT 1697-1698.)

353. During February and April 1991, Austin Bernet purchased 1.45 million units of Future Funding Corporation at prices ranging from $.110 per unit to $.115 per unit. (PX 230 at Bates Nos. 0000591, 0000593.) Thereafter, Future Funding Corporation changed its name to Site-Based Media, Inc. (PX 230 at 0000596; Brennan TT 1738-1739.) During August and September 1991, Austin Bernet sold its 1,450,000 Site-Based units for $4.00 per unit. (PX 230 at Bates Nos. 0000596-597.) Taking all its trading in Site-Based Media together, Austin Bernet made a profit in excess of $25 million. (Brennan TT 1774-1775.) In October 1991, the New Jersey State Bureau of Securities suspended trading in Site-Based shares in the State of New Jersey. (Brennan TT 1775-1776.)

354. Austin Bernet and three Brennan family trusts have held positions in Sanyo Industries, Inc. (Brennan TT 1777-1778.) In December 1992, the Commission suspended trading in Sanyo securities in view of questions about the adequacy and accuracy of publicly-disseminated information concerning, among other things, the identity of persons having control of Sanyo and the beneficial ownership of that company's securities. (PX 231A; Brennan RR 1780-1781.)

The foregoing, together with the appendices hereafter, constitute the Court's detailed findings of fact.

New York, New York
June 19, 1995

s/Richard Owen
United States District Judge

APPENDIX A
"PINK SHEET" LISTINGS FOR SOVEREIGN SECURITIES
NOVEMBER 9, 1982–DECEMBER 1, 1982

Date	Broker-Dealer	Type of Sovereign Security
November 9- November 18	NO LISTINGS	
November 19	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common
November 22	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common
November 23	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common
November 24	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common
November 26	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common
November 29	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common

November 30	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common
December 1	Nash Weiss & Co., Inc.	Common
	Herzog Heine Geduld, Inc.	Common/Units
	First Jersey Securities	Common

(Sovereign Pink Sheets, PX 23.)

APPENDIX B
"PINK SHEET" LISTINGS FOR RAMPART SECURITIES NOVEMBER 1, 1982-DECEMBER 3, 1982[1/]

Common Stock

Date	Broker-Dealer	Bid
November 1	First Jersey Securities	
	Hill Thompson Magid Co.	
	Herzog Heine Geduld, Inc.	
	Mayer & Schweitzer	
	M.H. Meyerson Co.	
	Troster Singer Co.	
	Carr & Thompson, Inc.	
November 2	First Jersey Securities	
	Hill Thompson Magid Co.	
	Herzog Heine Geduld, Inc.	
	Mayer & Schweitzer	
	M.H. Meyerson Co.	
	Troster Singer Co.	
	Carr & Thompson, Inc.	
November 3	First Jersey Securities	
	Hill Thompson Magid Co.	
	Herzog Heine Geduld, Inc.	
	Mayer & Schweitzer	
	M.H. Meyerson Co.	
	Troster Singer Co.	
	Carr & Thompson, Inc.	

[1/] From November 1 through November 15, 1982, Rampart common stock appeared on NASDAQ.

Date	Broker-Dealer	Bid
November 4	First Jersey Securities	
	Hill Thompson Magid Co.	
	Herzog Heine Geduld, Inc.	
	Mayer & Schweitzer	
	M.H. Meyerson Co.	
	Troster Singer Co.	
	Carr & Thompson, Inc.	
November 5	First Jersey Securities	
	Hill Thompson Magid Co.	
	Herzog Heine Geduld, Inc.	
	Mayer & Schweitzer	
	M.H. Meyerson Co.	
	Troster Singer Co.	
	Carr & Thompson, Inc.	
November 8	First Jersey Securities	
	Hill Thompson Magid Co.	
	Herzog Heine Geduld, Inc.	
	Mayer & Schweitzer	
	M.H. Meyerson Co.	
	Troster Singer Co.	
	Carr & Thompson, Inc.	
November 9	First Jersey Securities	
	Hill Thompson Magid Co.	
	Herzog Heine Geduld, Inc.	
	Mayer & Schweitzer	
	M.H. Meyerson Co.	
	Troster Singer Co.	
	Carr & Thompson, Inc.	

Date	Broker-Dealer	Bid	
November 10	First Jersey Securities		
	Hill Thompson Magid Co.		
	Herzog Heine Geduld, Inc.		
	Mayer & Schweitzer		
	M.H. Meyerson Co.		
	Troster Singer Co.		
	Carr & Thompson, Inc.		
November 11	First Jersey Securities		
	Hill Thompson Magid Co.		
	Herzog Heine Geduld, Inc.		
	Mayer & Schweitzer		
	M.H. Meyerson Co.		
	Troster Singer Co.		
	Carr & Thompson, Inc.		
November 12	First Jersey Securities		
	Hill Thompson Magid Co.		
	Herzog Heine Geduld, Inc.		
	Mayer & Schweitzer		
	M.H. Meyerson Co.		
	Troster Singer Co.		
	Carr & Thompson, Inc.		
November 15	First Jersey Securities	1 ½	2
	Hill Thompson Magid Co.		
	Herzog Heine Geduld, Inc.		
	Mayer & Schweitzer	1 ¼	1 ⅝
	M.H. Meyerson Co.		
	Troster Singer Co.		
	Carr & Thompson, Inc.		
November 16	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.		
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		

November 17	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.		
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
November 18	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	2	2 ½
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
November 19	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	2	2 ½
	Mayer & Schweitzer	1 ¾	2 ¼
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
November 22	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	2	2 ½
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
November 23	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	2	2 ½
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		

Date	Broker-Dealer	Bid	Asked
November 24	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	1 ⅞	2 ¼
	Mayer & Schweitzer	1 ¾	2 ⅛
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		

November 26	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	1 ⅞	2 ¼
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		
November 29	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	1 ⅞	2 ¼
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		
November 30	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	1 ⅞	2 ¼
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		
December 1	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	1 ⅞	2 ¼
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		
	Troster Singer Co.		
December 2	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	1 ⅞	2 ¼
	Mayer & Schweitzer		
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		
	Troster Singer Co.		

Date	Broker-Dealer	Bid	Asked
December 3	First Jersey Securities	1 ½	2
	Herzog Heine Geduld, Inc.	1 ⅞	2 ¼
	Mayer & Schweitzer	1 ½	2
	Carr & Thompson, Inc.		
	Hill Thompson Magid Co.		
	Universal Heritage Investments		
	Troster Singer Co.		

(Rampart Pink Sheets, PX 22.)

1987 Warrants

Date Asked	Broker-Dealer	Bid	
November 1	Mayer & Schweitzer		
November 2	Mayer & Schweitzer		
November 3	Mayer & Schweitzer		
November 4	Mayer & Schweitzer	⅛	⅝
November 5	Mayer & Schweitzer		
November 8	Mayer & Schweitzer		
November 9	Mayer & Schweitzer		
November 10	Mayer & Schweitzer		
November 11	Mayer & Schweitzer	⅛	⅝
November 12	Mayer & Schweitzer		
November 15	First Jersey Securities		
	Mayer & Schweitzer		

Date	Broker-Dealer	Bid	Asked
November 16	First Jersey Securities Mayer & Schweitzer		
November 17	First Jersey Securities Mayer & Schweitzer		
November 18	First Jersey Securities Mayer & Schweitzer		
November 19	First Jersey Securities Mayer & Schweitzer	1/8	5/8
November 22	First Jersey Securities Mayer & Schweitzer		
November 23	First Jersey Securities Mayer & Schweitzer Universal Heritage Investments		
November 24	First Jersey Securities Mayer & Schweitzer Universal Heritage Investments	1/8	5/8
November 26	First Jersey Securities Mayer & Schweitzer Universal Heritage Investments		
November 29	First Jersey Securities Mayer & Schweitzer Universal Heritage Investments		
November 30	First Jersey Securities Mayer & Schweitzer Universal Heritage Investments		

Date Asked	Broker-Dealer	Bid
December 1	First Jersey Securities	
	Mayer & Schweitzer	
	Universal Heritage Investments	
December 2	First Jersey Securities	
	Mayer & Schweitzer	
	Universal Heritage Investments	
December 3	First Jersey Securities	
	Mayer & Schweitzer	3/8
	Universal Heritage Investments	

(Rampart Pink Sheets, PX 22.)

APPENDIX C
"PINK SHEET" LISTINGS FOR QUASAR SECURITIES[1/]
JANUARY 10, 1983-JANUARY 31, 1983

Date	Broker-Dealer	Bid	Asked
January 10	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼
January 11	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼
January 12	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼
January 13	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼
January 14	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼

[1/] Only common stock appeared in the pink sheets during the period covered.

Date	Broker-Dealer	Bid	Asked
January 17	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼
January 18	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼
January 19	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp.	½	1 ¼
January 20	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp. First Jersey Securities	½	1 ¼
January 21	Greentree Securities Hill Thompson Magid Co. Wechsler & Krumholz Inc. Jesup & Lamont Securities Carr Securities Corp. First Jersey Securities	½	1 ¼

Date	Broker-Dealer	Bid	Asked
January 24	Greentree Securities		
	Hill Thompson Magid Co.		
	Wechsler & Krumholz Inc.		
	Jesup & Lamont Securities	½	1 ¼
	First Jersey Securities		
January 25	Greentree Securities		
	Hill Thompson Magid Co.		
	Wechsler & Krumholz Inc.		
	Jesup & Lamont Securities	½	1 ¼
	First Jersey Securities		
January 26	Greentree Securities		
	Hill Thompson Magid Co.		
	Wechsler & Krumholz Inc.		
	Jesup & Lamont Securities	½	1 ¼
	First Jersey Securities		
January 27	Greentree Securities		
	Hill Thompson Magid Co.		
	Wechsler & Krumholz Inc.		
	Jesup & Lamont Securities	½	1 ¼
	First Jersey Securities		
January 28	Greentree Securities		
	Hill Thompson Magid Co.		
	Wechsler & Krumholz Inc.		
	Jesup & Lamont Securities	½	1 ¼
	First Jersey Securities		
January 31	Greentree Securities		
	Hill Thompson Magid Co.		
	Wechsler & Krumholz Inc.		
	Jesup & Lamont Securities	½	1 ¼
	First Jersey Securities		

(Quasar Pink Sheets, PX 24.)

APPENDIX D
"PINK SHEET" LISTINGS FOR TRANSNET SECURITIES[1/]
NOVEMBER 10, 1983-DECEMBER 23, 1983

Date	Broker-Dealer	Type of Transnet Security
November 10	Herzog Heine Geduld, Inc.	Common\W1\W3
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 11	Herzog Heine Geduld, Inc.	Common\W1\W3
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 14	Herzog Heine Geduld, Inc.	Common\W1\W3
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3

[1/] Transnet common stock, but no other Transnet security, was also listed on NASDAQ throughout the period covered by this chart.

Date	Broker-Dealer	Type of Transnet Security
November 15	Herzog Heine Geduld, Inc.	Common\W1\W3
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 16	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 17	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 18	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3

Date	Broker-Dealer	Type of Transnet Security
November 21	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 22	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 23	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 25	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3

Date	Broker-Dealer	Type of Transnet Security
November 28	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 29	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
November 30	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
December 1	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3

Date	Broker-Dealer	Type of Transnet Security
November 28	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	W1\W3
December 5	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 6	Herzog Heine Geduld, Inc.	Common
	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 7	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3

Date	Broker-Dealer	Type of Transnet Security
December 8	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 9	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 12	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 13	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 14	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3

Date	Broker-Dealer	Type of Transnet Security
December 15	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 16	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 19	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 20	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 21	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3

Date	Broker-Dealer	Type of Transnet Security
December 22	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3
December 23	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common
	Sherwood Securities	Common
	Troster Singer Co.	Common
	First Jersey Securities	Common\W1\W3

(Transnet Pink Sheets, PX 25.)

APPENDIX E
"PINK SHEET" LISTINGS FOR SEQUENTIAL SECURITIES
JUNE 13, 1984–JULY 6, 1984

Units

Date	Broker-Dealer	Bid	Asked
June 13	M.H. Meyerson & Co.		
June 14	M.H. Meyerson & Co.		
June 15	M.H. Meyerson & Co.		
June 18	M.H. Meyerson & Co.		
June 19	M.H. Meyerson & Co.		
June 20	M.H. Meyerson & Co.		
June 21	M.H. Meyerson & Co.		
June 22	M.H. Meyerson & Co.		
June 25	M.H. Meyerson & Co.		
June 26	M.H. Meyerson & Co.		
June 27	M.H. Meyerson & Co.		
June 28	M.H. Meyerson & Co. Herzog, Heine Geduld Inc.		
June 29	M.H. Meyerson & Co. Herzog, Heine Geduld Inc.		
July 2	M.H. Meyerson & Co. Herzog, Heine Geduld Inc.		
July 3	M.H. Meyerson & Co. Herzog, Heine Geduld Inc.		

Units

Date	Broker-Dealer	Bid	Asked
July 5	M.H. Meyerson & Co. Herzog, Heine Geduld Inc.		
July 6	M.H. Meyerson & Co. Herzog, Heine Geduld Inc.		

(Sequential Pink Sheets, PX 26.)

Common Stock

Date	Broker-Dealer	Bid	Asked
June 13	M.H. Meyerson & Co.		
	Greentree Securities		
	Troster Singer	—	.06
	Herzog, Heine Geduld Inc.	.03	.08
	Nash Weiss & Co.		
	Mayer & Schweitzer Inc.		
	Muller & Co.		
	Herzfeld & Stern Inc.		
June 14	M.H. Meyerson & Co.		
	Greentree Securities		
	Troster Singer	—	.06
	Herzog, Heine Geduld Inc.	.03	.08
	Nash Weiss & Co.		
	Mayer & Schweitzer Inc.		
	Muller & Co.		
	Herzfeld & Stern Inc.		
June 15	M.H. Meyerson & Co.		
	Greentree Securities		
	Troster Singer	—	.06
	Herzog, Heine Geduld Inc.	.03	.08
	Nash Weiss & Co.		
	Mayer & Schweitzer Inc.		
	Muller & Co.		

Common Stock

Date	Broker-Dealer	Bid	Asked
June 18	M.H. Meyerson & Co.		
	Greentree Securities		
	Troster Singer	—	.06
	Herzog, Heine Geduld Inc.	.03	.08
	Nash Weiss & Co.		
	Mayer & Schweitzer Inc.		
	Muller & Co.		
June 19	M.H. Meyerson & Co.		
	Greentree Securities		
	Troster Singer	—	.06
	Herzog, Heine Geduld Inc.	.03	.08
	Nash Weiss & Co.		
	Mayer & Schweitzer Inc.		
	Muller & Co.		
June 20	M.H. Meyerson & Co.		
	Greentree Securities		
	Troster Singer	—	.06
	Herzog, Heine Geduld Inc.	.05	.12
	Nash Weiss & Co.		
	Mayer & Schweitzer Inc.		
	Muller & Co.		
June 21	M.H. Meyerson & Co.		
	Greentree Securities		
	Troster Singer	1/16	3/16
	Herzog, Heine Geduld Inc.	.05	.12
	Nash Weiss & Co.		
	Mayer & Schweitzer Inc.		
	Muller & Co.		

Common Stock

Date	Broker-Dealer	Bid	Asked
June 22	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc. Muller & Co.	.05	.12
June 25	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc. Muller & Co. Robert Tanney	.05	.12
June 26	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc. Muller & Co.	.05	.12
June 27	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc. Muller & Co. Robert Tanney	.10 .08	.14 —

Common Stock

Date	Broker-Dealer	Bid	Asked
June 28	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc.	.10	.14
	Muller & Co. Robert Tanney	.08	—
June 29	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc.	.10	.14
	Muller & Co. Robert Tanney	.08	—
July 2	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc.	.10	.14
	Muller & Co. Robert Tanney	.08	—
July 3	M.H. Meyerson & Co. Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc.	.10	.14
	Muller & Co. Robert Tanney	.08	—

Common Stock

Date	Broker-Dealer	Bid	Asked
July 5	M.H. Meyerson & Co. Greentree Securities Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc. Muller & Co. Robert Tanney	.10 "Offer Wanted"	.14
July 6	M.H. Meyerson & Co. Greentree Securities Herzog, Heine Geduld Inc. Nash Weiss & Co. Mayer & Schweitzer Inc. Muller & Co. Robert Tanney	.08 "Offer Wanted"	.12

(Sequential Pink Sheets, PX 26.)

APPENDIX F
"PINK SHEET" LISTINGS FOR QT&T SECURITIES[1/]
JANUARY 28, 1985–FEBRUARY 15, 1985

Date	Broker-Dealer	Type of QT&T Security
January 28	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wechsler & Krumholz	Common
	Wien Securities	Common
January 29	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wechsler & Krumholz	Common
	Wien Securities	Common
January 30	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common

[1/] QT&T Common also appeared on NASDAQ during the period.

Date	Broker-Dealer	Type of OT&T Security
January 31	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 1	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 4	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 5	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common

Date	Broker-Dealer	Type of OT&T Security
February 6	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 7	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 8	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 11	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common

Date	Broker-Dealer	Type of OT&T Security
February 12	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 13	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common
February 14	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common

Date	Broker-Dealer	Type of OT&T Security
February 15	Jesup & Lamont	Common
	Mayer & Schweitzer	Common
	M.H. Meyerson	Common\'88 Wts.
	Nash Weiss	Common\'88 Wts.
	Sherwood Securities	Common\Units\'88 Wts.
	Troster Singer Co.	Common\'88 Wts.
	Wien Securities	Common

(QT&T Pink Sheets, PX 27.)

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 27 day of February one thousand nine hundred and ninety-seven.

SEC

v Dkt No: 95-6192

First Jersey Securities, Inc.

A petition for rehearing containing a suggestion that the action be *reheard* in banc having been filed herein by the appellant First Jersey Securities, Inc.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active service and

to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By: s/Beth J. Meador
Beth J. Meador,
Administrative Attorney

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

- v -

FIRST JERSEY SECURITIES, INC. and ROBERT E. BRENNAN,

Defendants.

85 Civ. 8585 (RO)

JUDGMENT

On October 31, 1985, plaintiff Securities and Exchange Commission ("Commission") brought this civil enforcement action against First Jersey Securities, Inc. ("First Jersey") and Robert E. Brennan ("Brennan"). The case came to trial on June 1, 1994, and continued for forty trial days through November 3, 1994. Post trial briefs and proposed findings of fact and conclusions of law were submitted by the parties on December 12, 1994, and closing arguments were heard on December 16, 1994. In its opinion and Detailed Findings of Fact dated June 19, 1995, this Court found that the defendants First Jersey securities, Inc. and Robert E. Brennan had engaged in a massive and continuing fraud upon the customers of First Jersey, thus violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. This court found further that plaintiff Commission is entitled to the following relief: (1) disgorgement in the sum of $22,288,099 together with prejudgment interest of $49,251,521 as of December 31, 1994, to be updated to the date of this Judgment and payable by the defendants jointly and severally; (2) permanent

injunctions against First Jersey and Brennan; and (3) the appointment of a Special Agent for the purpose of ascertaining whether defendants charged excessive markups and/or markdowns to First Jersey customers beyond those proved at trial. Accordingly,

I.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that 1) defendants First Jersey and Brennan, their officers, agents, servants, employees and attorneys, and 2) those persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise, and each of them be and they hereby are permanently restrained and enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. § 78j(b)], and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5], by, directly or indirectly, using any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:

(A) to employ any device, scheme, or artifice to defraud;

(B) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(C) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

II.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that 1) defendants First Jersey and Brennan, their officers, agents, servants, employees and attorneys, and 2) those

persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise, and each of them be and they hereby are permanently restrained and enjoined from violating Section 17(a) of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77q(a)] by, in the offer or sale of any securities, using any means or instruments of transportation or communication in interstate commerce, or using the mails, directly or indirectly to:

(A) employ any device, scheme, or artifice to defraud;

(B) obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(C) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon a purchaser.

III.

IT IS ORDERED, ADJUDGED AND DECREED that defendants First Jersey and Brennan jointly and severally shall pay by August 13, 1995 disgorgement in the sum of $22,288,099 in United States dollars plus prejudgment interest accrued through June 30, 1995 of $52,689,893.99, and statutory postjudgment interest pursuant to 28 U.S.C. § 1961, from the date of entry of judgment up to and including, the date that the full amount of disgorgement plus interest is paid, in United States dollars in the following manner:

(A) Payment shall be made to the Registry of this Court by certified check or money order drawn on a United States bank made payable to "Clerk, United States District Court, S.D.N.Y."

(B) At the same time payment is remitted, the defendant making payment shall send a photocopy of his check or money order to the Secretary of the SEC at the following address:

Office of the Secretary
450 Fifth Street, N.W.,
Mail Stop 6-9
Washington, D.C. 20549.

The photocopy shall be accompanied by a letter that identifies the defendant making payment, the civil action number assigned to the Complaint, the District Court in which the Complaint and this Judgment were filed, and the Commission's internal case number (HO-1876).

(C) Upon receipt, the Financial Deputy Clerk shall deposit such check or money order into an interest bearing account with the Court Registry Investment System ("CRIS"). (The principal and accrued interest, together with income generated through the investment of such monies, is hereinafter referred to as the "Fund").

(D) The disgorgement and prejudgment interest thus paid shall be held by the CRIS until further order of the Court.

(E) Interest earned on the money in the Fund shall be credited to the Fund and treated in the same manner as principal.

(F) In accordance with the guidelines set by the Director of the Administrative Office of the United States Court, the Clerk of the Court is directed, without further order of this Court, to deduct from the income earned on the money in the Account a fee equal to 10 percent of the income earned on the

investment so held. Such fee shall not exceed that authorized by the Judicial Conference of the United States.

(G) The Commission may prepare and submit plans for disposition of Fund monies for the Court's consideration. Such plans may provide for the appointment of a Fund Administrator to conserve the funds in the Account and to oversee a Court-approved plan of distribution.

IV.

IT IS ORDERED, ADJUDGED AND DECREED that the Commission may move the Court for the appointment of a Tax Accountant to prepare and file appropriate tax returns for the Fund, and that the Fund shall pay the fees and expenses of such Tax Accountant and any tax liabilities of the Fund as a separate tax paying entity resulting from income generated through the investment of monies in the Fund.

V.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Fund shall pay the fees and expenses of the Special Agent appointed pursuant to paragraph VI below incurred in connection with and incidental to the performance of the Special Agent's duties. Defendants First Jersey and Brennan are further ordered to reimburse the Fund in full for all such fees and expanses as are approved by the Court on a quarterly basis, as directed by further Orders of the Court.

VI.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that a Special Agent be appointed by the Court for the purpose of examining the records of First Jersey for the period from November 1, 1982 through January 31, 1987, to ascertain whether defendants charged excessive markups and/or markdowns

to First Jersey customers beyond those proved at trial and to make appropriate recommendations to the Court. The Special Agent shall be selected by the Court from a list of at least 3 candidates to be submitted by the Commission within 20 days of the signing of this Judgment. The defendants shall then have 10 days to comment upon or object to particular candidates, but shall have no veto power over the selection of any particular candidate by the Court. The powers and duties of the Special Agent shall be set out by the Court in a subsequent Order.

VII.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that First Jersey and Brennan, their officers, directors, agents, affiliates, servants, employees, attorneys and assigns (if any), and those persons in active concert or participation with them, and each of them, be and they hereby are enjoined from destroying, mutilating, concealing, altering, or disposing of any books, records, contracts, receipts, agreements, or other documents which relate or pertain to or reflect defendants' underwriting and retain brokerage activities engaged in during the period from November 1, 1982 through January 31, 1987.

VIII.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this Court shall retain jurisdiction of this matter for the purposes of implementing and enforcing the terms of this Judgment.

There being no just cause for delay, the Clerk of the Court hereby is directed, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, to enter this Judgment forthwith.

s/Richard Owen
UNITED STATES DISTRICT JUDGE

Dated: July 14, 1995

Ex. D-551

DISGORGEMENT SCHEDULE
Assumes SEC Markups in Excess of 10%

Year	Issuer	Markups In Excess of 10% Per SEC	FJS Total Revenue From Certified Income Statement	% Of Excess Markup vs Total Revenue
1982	Sovereign Chemical	$3,950,631	$48,415,578	8.16%
1982	Rampart General	$774,986	$48,415,578	1.60%
1983	Quasar Micro-Systems	$5,329,507	$85,258,471	6.25%
1983	Transnet Corp.	$654,410	$85,258,471	0.77%
1984	Sequential Information Systems	$7,947,285	$92,993,555	8.55%
1985	QT&T Inc.	$194,345	$95,660,415	0.20%
		$18,851,164		

Ex. D-551

DISGORGEMENT SCHEDULE

Assumes SEC Markups in Excess of 10%

Year	Issuer	Total Annual Brennan Withdrawal	Brennan Withdrawals Based On % Of Excess Markup vs Total Revenue	Balance Of Excess Markup Based On SEC Attributable To FJS Before Adjustments
1982	Sovereign Chemical	$3,983,775	$325,069	$3,625,562
1982	Rampart General	$3,983,775	$63,768	$711,218
1983	Quasar Micro-Systems	$3,115,438	$194,746	$5,134,761
1983	Transnet Corp.	$3,115,438	$23,913	$630,497
1984	Sequential Information Systems	$3,419,000	$292,190	$7,655,095
1985	QT&T Inc.	$3,438,680	$6,986	$187,359
			$906,672	$17,944,492

Ex. D-551

DISGORGEMENT SCHEDULE

Assumes SEC Markups in Excess of 10%

Year	Issuer	Balance Of Excess Markup Based On SEC Attributable To FJS Before Adjustments	Total Revenue From Certified Income Statement	% Of Excess Markup Attributable To FJS vs Total Revenue
1982	Sovereign Chemical	$3,625,562	$48,415,578	7.49%
1982	Rampart General	$711,218	$48,415,578	1.47%
1983	Quasar Micro-Systems	$5,134,761	$85,258,471	6.02%
1983	Transnet Corp.	$630,497	$85,258,471	0.74%
1984	Sequential Information Systems	$7,655,095	$92,993,555	8.23%
1985	QT&T Inc.	$187,359	$95,660,415	0.20%

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE FIRST JERSEY SECURITIES, INC.
SECURITIES LITIGATION

This Document Relates To:
All Actions

ROBERT SPATOLA; RICHARD BROWN;
ARNOLD KRAENBRING; T. PETER
BRIDGE, M.D.; MYRNA RICHARDSON;
and JACK ZAKIM, individually and
as trustee for Jordana Zakim,
Plaintiffs,

v.

FIRST JERSEY SECURITIES, INC.,
et al.,
Defendants.

M.D.L. DOCKET NO. 681
CIVIL ACTION
CLASS ACTION
NO. 85-6059

STIPULATION OF SETTLEMENT

WHEREAS:

A. The above-captioned actions were brought by plaintiffs as purchasers or sellers of certain securities through First Jersey Securities, Inc. ("*First Jersey*") on behalf of themselves and all other persons who purchased or sold certain securities through First Jersey during the period October 1, 1980 through September 30, 1986 (the "*Class Period*"), against First Jersey and certain of its present or former officers, directors and employees; and

B. By Order entered April 10, 1986, the Judicial Panel on Multidistrict Litigation transferred the above-captioned *Zakim* action from the District Court for the District of New Jersey to this Court for coordination or consolidation under 28 U.S.C. Section 1407; and

C. A Consolidated Complaint was filed in these actions on or about January 9, 1987; and

D. By order entered , 1987 this Court certified a class and certain subclasses in this action for purposes of settlement only; and

E. The complaints in these actions and the Consolidated Complaint allege violations by defendants of the securities laws of the United States and rules and regulations of the Securities and Exchange Commission promulgated thereunder, the Employee Retirement Income Security Act ("*ERISA*"), as well as violations of RICO and state law. Plaintiffs collectively allege that the defendants entered into an unlawful scheme and course of conduct. The alleged purpose of defendants' conduct was to create actual or apparent active trading in, to charge excessive markups and markdowns in, and artificially inflate the price of, artificially inflate the price of, securities that First Jersey owned, and for its own account sold to (or for its own account purchased from) plaintiffs and members of the class they purport to represent as more fully described in plaintiffs' Consolidated Complaint. The plaintiffs contend that defendants received improper and unlawful profits and ill-gotten gains and that plaintiffs and other class members suffered substantial losses as a direct result of the matters challenged in this litigation; and

F. Each of the defendants in this litigation has filed Answers, Motions to Dismiss and/or Motions for Judgment on the Pleadings to each of the original above-captioned complaints, denying all allegations of liability therein, asserting affirmative defenses thereto, and demanding judgment on the merits dismissing the complaints which are pending; and

G. Plaintiffs' counsel have conducted an extensive investigation relating to plaintiffs' claims and the underlying events and transactions alleged in the complaints, including inspecting thousands of documents produced by First Jersey and by various non-parties pursuant to Rules 26, 30, 33, 34, and 45 of the Federal Rules of Civil Procedure and taking depositions of parties and non-parties. Plaintiffs' counsel have also made a thorough study of the legal principles applicable to plaintiffs' claims herein and have retained consultants to evaluate the documents and other evidence available to plaintiffs; and

H. Plaintiffs' counsel have engaged in intensive arm's length negotiations with defense counsel with respect to the settlement of plaintiffs' claims against the defendants. Plaintiffs desire to settle their claims against the defendants in this litigation on the terms and conditions hereafter set forth, and deem such settlement to be fair, reasonable, and adequate and in the best interests of the members of the Class; and

I. First Jersey, Robert E. Brennan, and John Dell, defendants herein, while vigorously denying all allegations of wrongdoing and liability, state that they desire to settle and terminate the plaintiffs' claims against defendants so as to avoid lengthy and time-consuming litigation and the burden, inconvenience, and expense connected therewith, without in any way acknowledging any fault or liability.

NOW, THEREFORE, IT IS HEREBY STIPULATED, CONSENTED TO, AND AGREED, by and among the undersigned parties, on behalf of their respective clients and the class, that these actions shall be settled, compromised, and dismissed, subject to the approval of the Court, in the manner and upon the terms and conditions hereafter set forth;

I. DEFINITIONS

1. "*Securities*" shall mean common stock, warrants, preferred stock, debentures, and units issued by the companies listed below which were purchased by a Class member from or

through First Jersey during the Class Period or which were sold by a Class member to or through First Jersey during the Class Period.

2. "*Class Securities*" shall mean the securities of the following companies, and all the predecessors and successors to these companies:

QT&T, Inc. (formerly Quasar Microsystems, Inc.)
Rampart General
Sovereign Chemical & Petroleum Products, Inc.
Advanced Energy Concepts, Inc.
American Heliothermal Corporation
Armstrong Laboratories, Inc.
ATI, Inc.
Calton, Inc.
Century Medicorp
Chefs International, Inc.
Diogenes Systems, Inc.
Dominion Resources Inc. (formerly Northern Arizona Gold & Silver Milling and Mining Company)
Electromedics, Inc.
Empire-Orr Inc.
Fireplace Manufacturers, Inc.
GBC Closed Circuit TV Corporation
General Aero Products Corp.
Geosearch, Inc.
Gibson Cryogenics, Inc.
Great American Recreation, Inc. (formerly Vernon Valley Recreation Association, Inc.)
Greer Software Associates, Inc. (formerly Greer Sontag Associates, Inc.)
Highline Industries, Inc. (formerly Sunsav, Inc.)
Holland Industries, Inc.

Imatron, Inc.
InterCare, Inc.
Levin International Corporation
(formerly Levin Computer Corporation)
Lincoln Logs, Inc.
Medical Dynamics, Inc.
Medivix, Inc.
Mitral Medical International
Odyssey Filmpartners, Ltd.
P&F Industries, Inc.
Pacific International Services Corp.
Peaches Entertainment Corporation
Pubco Corporation
Reprotech, Inc.
Sequential Information Systems, Inc.
Stony Point Recreation Corporation
ThermoDynetics, Inc.
Trans Atlantic Games, Inc.
Transnet Corporation
URT Industries, Inc.
(formerly United Record & Tape)
Wright Air Lines, Inc.

3. (a) The "*Class*" in this litigation, as alleged in the Consolidated Complaint and as conditionally certified for settlement purposes only by Order of the Court, consists of three subclasses. Subclass A consists of all those Class Members who purchased and/or sold through First Jersey, during the Class Period securities of QT&T, Inc., Rampart General, Inc., and/or Sovereign Chemical & Petroleum Products, Inc.

(b) Subclass B consists of all those Class Members who purchased and/or sold through First Jersey, during the Class Period, securities of the following companies:

Advanced Energy Concepts, Inc.
Armstrong Laboratories, Inc.
ATI, Inc.

Calton, Inc.
Century Medicorp
Electromedics, Inc.
Geosearch, Inc.
Gibson Cryogenics, Inc.
Highline Industries, Inc.
(formerly Sunsav, Inc.)
Holland Industries, Inc.
Imatron, Inc.
Levin International Corporation
(formerly Levin Computer Corporation)
Medical Dynamics, Inc.
Mitral Medical International
Odyssey Filmpartners, Ltd.
Stony Point Recreation Corporation
Trans Atlantic Games, Inc.

(c) Subclass C consists of all those Class Members who purchased and/or sold through First Jersey, during the Class Period, securities of the following companies:

American Heliothermal Corporation
Chefs International, Inc.
Diogenes Systems, Inc.
Dominion Resources Inc.
(formerly Northern Arizona Gold & Silver Milling and Mining Company)
Empire-Orr Inc.
Fireplace Manufacturers, Inc.
GBC Closed Circuit TV Corporation
General Aero Products Corp.
Great American Recreation, Inc.
(formerly Vernon Valley Recreation Association, Inc.)
Greer Software Associates, Inc.
(formerly Greer Sontag Associates, Inc.)

InterCare, Inc.
Lincoln Logs, Inc.
Medivix, Inc.
P&F Industries, Inc.
Pacific International Services Corp.
Peaches Entertainment Corporation
Pubco Corporation
Reprotech, Inc.
Sequential Information Systems, Inc.
ThermoDynetics, Inc.
Transnet Corporation
URT Industries, Inc.
(formerly United Record & Tape)
Wright Air Lines, Inc.

Excluded from the Class are: the defendants, the registered representatives employed by First Jersey during the Class Period and members of their immediate families; any entity controlled by any of the defendants; and any market maker in any of the Class securities.

4. "*Final Approval*" of the settlement shall occur when: (a) a final judgment shall have been entered by this Court approving and confirming this Settlement and dismissing these actions on the merits, without prejudice, and without costs, on the basis of this Settlement, as to the plaintiffs and as to all members of the Class together with their respective heirs, executors, successors in interest and assigns (see paragraph 16 below); and (b) either five (5) days shall have elapsed after the expiration of time from the judgment to which the preceding subparagraph refers without any appeal or appeals being taken therefrom, or five (5) days shall have elapsed after such appeal or appeals shall have been finally determined or disposed of in such a matter as to permit the disposition pursuant to this settlement of all claims made in these actions, whichever shall later occur. For purposes of this subparagraph, an "*appeal*" shall include any petition for writ of certiorari that may be filed in connection with approval or disapproval of this settlement.

5. "*Recognized Settlement Claim*" is the total dollar amount of all transactions a member of the Class entered into through First Jersey in purchasing and/or selling Class securities during the Class Period from October 1, 1980, through and including September 30, 1986.

B. Establishment Of The Cash Fund

6. In full and final settlement of this litigation, defendants shall cause the sum of ten million dollars ($10,000,000) (the "*Settlement Fund*") to be paid in to escrow with Philadelphia National Bank with David Berger, Esquire and Leonard Barrack, Esquire acting as co-escrow agents under the following terms and conditions and pursuant to the Escrow Agreement attached hereto as Exhibit "A".

(a) Defendants shall deposit the sum of five million dollars ($5,000,000) within ten (10) days of the signing of this Stipulation of Settlement ("*Stipulation*");

(b) Defendants shall deposit the sum of five million dollars ($5,000,000) within thirty (30) days following the date on which final judgment shall have been entered by this Court approving and confirming this Settlement and dismissing these actions on the merits, with prejudice, and without costs, on the basis of this Settlement, as to the plaintiffs and as to all members of the Class together with their respective heirs, executors, successors in interest and assigns. In connection with the Settlement Fund, defendants First Jersey and Brennan shall deliver to Plaintiffs' Lead Counsel, Berger & Montague, P.C., within seven (7) days from the date this Stipulation is fully executed, a promissory notes in the amount of $5 million in the form attached hereto as Exhibit "B".

(c) The amounts so deposited shall, as soon as practicable, be invested in:

(i) United States Treasury Bills or other similar United States Government obligations; and/or

(ii) One demand deposit account which account is insured with an agency of the United States Government.

7. (a) Interest earned on the Settlement Fund deposited pursuant to paragraph 6 above shall be added to the Settlement Fund for the benefit of members of subclasses B and C, and shall continue to be held in escrow by the Escrow Agents for the period described in section C below; and

(b) Except as provided by paragraph 9(a) below, if the Settlement and all of its constituent parts are not approved, or if the documents contemplated by the parties to be entered by the Court pursuant to the settlement, including but not limited to the Final Judgment and Order of Dismissal attached as Exhibit D to the Hearing Order, are not so entered, or if approval of the Settlement, including the entry of orders contemplated by the parties to be entered by the Court pursuant to the settlement, including but not limited to the Final Judgment and Order of Dismissal attached as Exhibit D to the Hearing Order, is reversed on appeal, the Settlement Fund, including all accrued interest, shall be returned to First Jersey and the Settlement shall be null and void and the conditional certification of this litigation to proceed on a class basis as ordered in the Hearing Order dated _____, 1987 shall be automatically dissolved and vacated without further order of the Court.

8. Distribution of monies from the Settlement Fund may be made only in accordance with Section C below. Neither the Escrow Agents nor any of their officers, directors, agents, or employees shall be liable for any action taken or omitted to be taken by them as Escrow Agents under or in connection with this agreement, except for gross negligence or willful misconduct.

C. Distribution Of The Cash Fund

9. The Settlement Fund, together with all interest accruing thereon, shall constitute the Gross Settlement Fund, and shall be distributed under the Court's direction and supervision in the following order and manner:

(a) Plaintiffs may use up to $50,000 of the Settlement Fund to pay the costs involved in connection with sending and publication of the Notice of the proposed Settlement and administering the Settlement up to the date of final approval. Such amount as used by plaintiffs for those purposes shall not be returned to First Jersey if this Settlement is not approved;

(b) To pay the fees, allowances, and disbursements of plaintiffs' attorneys to the extent approved by the Court;

(c) To pay further costs of notice, processing proofs of claim and distributing the Settlement Fund to Class members;

(d) The fees, costs, allowances and expenses pursuant to paragraph 9(a), (b) and (c) above, shall be deducted from the Gross Settlement Fund. Thereafter, the balance of the Gross Settlement Fund (the "*Net Settlement Fund*") shall be paid to members of the Class in the manner and in accordance with the procedures provided below.

10. No distribution shall be made to plaintiffs' counsel or Class members pursuant to paragraphs 9(b), (c) and (d) above until final approval of this Stipulation and Settlement.

11. Plaintiffs shall within three days of the signing of this Stipulation, select the administrator of the Settlement which shall be a Certified Public Accounting firm. Counsel for First Jersey must approve the selection of the administrator, but such approval shall not be unreasonably withheld. Defendants' counsel may observe and monitor the activities of the administrator at defendants' sole expense.

12. The Gross Settlement Fund shall be for the benefit of members of the Class as follows:

(a) Five million dollars ($5,000,000), less 50% of the charges assessed against the Gross Settlement Fund pursuant

to paragraph 9(d) shall be for the benefit of members of Subclass A in the specific amounts listed below less the charges:

(i) those members of Subclass A with transactions in QT&T, Inc. — $2,500,000;

(ii) those members of Subclass A with transactions in Rampart General, Inc. — $600,000; and

(iii) those members of Subclass A with transactions in Sovereign Chemical & Petroleum Products, Inc. — $1,900,000.

It is expressly understood by the parties that the amounts set forth in 12(a) are being paid by defendants for the additional purpose of resolving by way of settlement, compromise and offset the disgorgement claims in *Securities & Exchange Commission v. First Jersey Securities, Inc., et al.*, 85 Civ. 8585 (S.D.N.Y.)(RO).

(b) Five million dollars ($5,000,000), plus all interest earned on the Settlement Fund, less 50% of the charges assessed against the Gross Settlement Fund pursuant to paragraph 9(d) shall be for the benefit of members of Subclasses B and C.

13. The Net Settlement Fund shall be used to satisfy claims submitted by members of the Class as follows:

(a) There shall be allocated and distributed to each member of Subclass A with transactions in the securities of QT&T, Inc. a pro rata share of the amount specified in paragraph 12(a)(i), determined by the ratio that such Class member's Recognized Settlement Claim in transactions in the securities of QT&T, Inc. bears to the total Recognized Settlement Claims in transactions in the securities of QT&T Inc. of all Class members whose claims are allowed by the terms of this Settlement;

(b) There shall be allocated and distributed to each member of Subclass A with transactions in the securities of Rampart General, Inc. a pro rata share of the amount specified in

paragraph 12(a)(ii), determined by the ratio that such Class member's Recognized Settlement Claim in transactions in the securities of Rampart General, Inc. bears to the total Recognized Settlement Claims in transactions in the securities of Rampart General, Inc. of all Class members whose claims are allowed by the terms of this Settlement;

(c) There shall be allocated and distributed to each member of Subclass A with transactions in the securities of Sovereign Chemical & Petroleum Products, Inc. a pro rata share of the amount specified in paragraph 12(a)(iii), determined by the ratio that such Class member's Recognized Settlement Claim in transactions in the securities of Sovereign Chemical & Petroleum Products, Inc. bears to the total Recognized Settlement Claims in transactions in the securities of Rampart General, Inc. of all Class members whose claims are allowed by the terms of this Settlement;

(d) The allocation and distribution to the members of Subclasses B and C shall be determined by a plan of allocation which weights each Class B Settlement share at two times the weight of each Class C Settlement share. Thereafter, each member of Subclasses B and C will receive a pro rata share of the amount specified in paragraph 12(b), determined by the ratio that such Class member's weighted Recongized Settlement Claim in transactions in the securities of all companies in Subclasses B and C bears to the total weighted Recognized Settlement Claim in transactions in the securities of all companies in Subclasses B and C of all Class members whose claims are allowed by the terms of this Settlement.

D. Submission Of Settlement To Court For Review

14. Promptly following execution of this Stipulation, counsel will present to the Court, in the form attached hereto as Exhibit C, an Order:

(a) setting a hearing, upon notice to members of the Settlement Class, on the question of whether the proposed Settlement should be approved as fair and reasonable to members

of the Class and on plaintiffs' counsels' request for counsel fees and reimbursement of expenses;

(b) approving the form of notice to Class members;

(c) prescribing the method of giving notice to the Class members;

(d) prescribing a period of time during which Class members may file requests to be excluded from the Class;

(e) prescribing a period of time during which Class members may serve written objections to the Settlement or request for counsel fees;

(f) prescribing a period of time during which Class members must file Proof of Claim forms in order to participate in the Net Settlement Fund.

15. For the purposes of determining the extent to which a member of the Class shall be entitled to receive a payment from the Net Settlement Fund, the following conditions shall apply:

(a) A firm of certified public accountants retained by plaintiffs in accordance with paragraph 11 hereof shall be responsible under the supervision of plaintiffs' lead counsel for the review, processing, calculation, administration of claims and the distribution of the Net Settlement Fund. Defendants or their representatives shall have the right to observe and monitor these activities and make copies of documents submitted by Class members for use in this litigation at defendants' sole expense. the expenses of the accountants retained by plaintiffs shall be paid from the Settlement Fund;

(b) Proof of Claim forms in the form attached hereto as Exhibit D, shall be executed and timely filed by Class members and supported by documentary evidence;

(c) All decisions with respect to the ultimate validity of any claim and the distribution of the Net Settlement Fund shall be made by counsel for plaintiffs subject to the approval of the Court upon notice to all counsel; and

(d) At the conclusion of the distribution of the Settlement Fund, the Proof of Claim forms received shall be forwarded to First Jersey.

16. If the Court approves this Settlement, then a judgment, in the form annexed as Exhibit D, to the Hearing Order shall be entered in this action as to plaintiffs and as to all Class members:

(a) approving this Settlement and its terms as being a fair, reasonable, and adequate settlement of this action and directing its consummation pursuant to its terms;

(b) directing that this action be dismissed without costs and upon the merits and with prejudice and in full and final discharge of any and all claims asserted in the Complaints in each of the above-captioned actions and the Consolidated Complaint, or which might have been asserted therein arising out of the subject matter of the complaints and the Consolidated Complaint, as against each of the defendants, their predecessors, successors, heirs, or assigns, any entity now, or in the past or hereafter controlled by them or controlling them, and the past and present partners, officers, directors, employees, agents, and attorneys of each of the defendants or of any entity controlled by them or controlling them;

(c) reserving jurisdiction over these actions, and over any and all further proceedings concerning the administration and consummation of this settlement;

(d) permanently barring and enjoining the institution and prosection, either directly or representatively, of any other action in any court asserting any claim alleged in the Complaints in the above-captioned actions or the Consolidated

Complaint or which might have been asserted therein arising out of the subject matter of the complaints or the Consolidated Complaint; and

(e) containing such other and further provisions consistent with the terms of this Settlement as the Court may deem advisable.

17. If persons who file valid and timely requests for exclusion from the Class in accordance with the provisions of the notice exceed certain specified limits as set forth in an agreement between counsel for defendants and counsel for plaintiffs, defendants may withdraw from this Settlement by filing notice of withdrawal with the Court, and the provisions of this Settlement thereupon shall be null and void with respect to the defendants so withdrawing, except with respect to the provisions of paragraph 9(a) hereof. If defendants fail to perform their obligations under paragraph 6 above, plaintiffs may withdraw from this Settlement by filing a notice of withdrawal with the Court, and the provisions of the Settlement thereupon shall be null and void. If defendants fails to perform their obligations pursuant to paragraph 6(b) above, the payment made pursuant to paragraph 6(a) above shall not be returned to defendants, and David Berger, Esquire, shall become sole Escrow Agent of the payment for the benefit of the Class, in addition to any other remedies.

18. It is expressly understood and agreed that this Settlement shall not constitute or be an admission for any purpose by any defendant or any other person, or be deemed evidence of any violation of any federal or state statute, law, rule, or regulation or an admission of any liability or wrong-doing by any defendant or any other person or of the validity or truth of any of the claims or allegations contained in the original Complaints in any of the above-captioned actions or the Consolidated Complaint.

19. The Settlement including the exhibits hereto shall be binding on and inure to the benefit of the heirs, successors, assigns, executors, and legal representatives of all parties. It constitutes a complete statement of the entire agreement among the

parties. Any agreement provided for herein and any agreement purporting to change the terms hereof including this paragraph must be in writing and signed by Lead Counsel for plaintiffs on behalf of all plaintiffs and counsel for defendants.

20. All documents produced by defendants to plaintiffs shall be returned to First Jersey at its expense or destroyed within 30 days of the final approval of the Settlement.

21. This Stipulation of Settlement shall be construed in accordance with the laws of the Commonwealth of Pennsylvania.

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Supreme Court, U.S.
FILED
JUL 23 1997
CLERK

No. 96-1862

In the Supreme Court of the United States

OCTOBER TERM, 1996

FIRST JERSEY SECURITIES, INC., ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether, in enforcement actions brought by the Securities and Exchange Commission, the federal courts' statutory authority to enjoin violations of the securities laws includes the ancillary equitable authority to order disgorgement of profits the defendants obtained as a result of their wrongdoing.

2. Whether the court of appeals properly held petitioner Brennan jointly and severally liable for the disgorgement.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-1862

FIRST JERSEY SECURITIES, INC., ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-47a) is reported at 101 F.3d 1450. The opinion of the district court (Pet. App. 48a-104a) is reported at 890 F. Supp. 1185. The district court's findings of fact (Pet. App. 105a-218a) are unreported.

JURISDICTION

The court of appeals entered its judgment on December 10, 1996. A petition for rehearing was denied on February 27, 1997. Pet. App. 219a-220a. The petition for a writ of certiorari was filed on May 23, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Section 20(b) of the Securities Act of 1933 (Securities Act) provides that, "[w]henever it shall appear to the [Securities and Exchange] Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of [the Act], or of any rule or regulation prescribed under authority thereof," the Commission may bring an action in federal court "to enjoin such acts or practices." 15 U.S.C. 77t(b). Section 21(d) of the Securities Exchange Act of 1934 (Exchange Act) contains a virtually identical provision. 15 U.S.C. 78u(d).

2. a. Petitioner Robert E. Brennan founded petitioner First Jersey Securities, Inc. (First Jersey) in 1974 as a discount broker-dealer specializing in the underwriting, trading, and distribution of low-priced securities. Pet. App. 3a.[1] At all relevant times, Brennan was both a director and the sole owner of First Jersey. From January 1982 to August 1985, Brennan also served as First Jersey's president. In September 1985, Brennan became First Jersey's chairman and chief executive officer. *Id.* at 6a.

Brennan was intimately involved in the day-to-day operations of First Jersey. He decided which securities First Jersey would underwrite and was involved in setting their prices. Pet. App. 7a. He participated in the formulation of the firm's pricing policies, regularly reviewed research reports on securities, and discussed with his staff First Jersey's compliance with rules regulating the securities trade. *Ibid.*

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[1] Petitioners do not challenge the district court's findings of fact.

b. From 1982 to 1985, "First Jersey, with Brennan at the helm, * * * employed a massive and coordinated system of fraudulent practices to induce its customers to buy certain securities from [First Jersey] at excessive prices unrelated to prevailing market prices." Pet. App. 3a. Petitioners hired hundreds of salespersons to carry out the scheme, seeking out prospective employees who had no prior experience in the securities business. *Id.* at 3a-5a.[2]

The fraudulent scheme generally operated as follows: Every month, each of petitioners' 32 domestic branch offices focused its efforts on selling one security, which was selected by First Jersey's home office. The salespersons contacted prospective buyers through "cold calls" to individuals who were not First Jersey customers and whose names were found in general directories. Pet. App. 4a. Follow-up calls were made to promising contacts with scripted sales pitches designed to close the sale of the selected security. *Ibid.* Petitioners designed the system to keep the salesforce uninformed about the securities they sold and indifferent to the needs and desires of customers. Salespersons were discouraged from conducting independent research, deviating from the scripted sales pitches, or promoting other securities. See *id.* at 4a-5a, 53a, 60a-61a. Petitioners tied compensation almost exclusively to success in selling the designated securities. *Id.* at 5a.

Petitioners employed this system to sell the six issues of securities involved here from one set of branch offices, to buy those securities back immedi-

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[2] The district court found that typical hires included a waiter, a bellman in a Playboy club, and a convenience store worker. Pet. App. 51a n.4.

ately from the original customers, and then to resell the securities through a different set of branch offices to a new group of customers, at prices up to 150% or more above the prices at which the securities had just been repurchased. Pet. App. 5a-6a. At each stage of the process—initial sale, repurchase, and resale—salespersons used scripts prepared and disseminated by petitioners to deceive the customers into believing that the transactions were occurring in a freely operating market and at market-determined prices. In fact, the market and the prices for the securities were created and controlled by First Jersey. As a result, the initial group of customers sold the securities back to First Jersey without being informed that the securities were to be immediately resold at a much higher price, while the second group purchased the securities at prices that were artificially inflated. *Id.* at 8a, 67a. Petitioners' fraud netted more than $27 million in unlawful profits. *Id.* at 13a.

3. In 1985, the Commission filed suit against petitioners, alleging that the sales scheme resulted in fraud on First Jersey's customers, in violation of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

Following a 41-day bench trial, the district court concluded that the Commission had "overwhelmingly proven" (Pet. App. 96a) that petitioners violated the antifraud provisions of the securities laws, both by withholding from customers the true nature of the First Jersey-created and -controlled market in which the transactions occurred and by charging fraudulently excessive markups on the securities. *Id.* at 67a-73a. The district court found that petitioners'

conduct "was entirely purposeful" and that they "orchestrated every facet" of First Jersey's operations to ensure that the securities "were sold *when* they wanted—*where* they wanted—at prices determined not by market forces but by First Jersey itself." *Id.* at 66a-67a. Moreover, the evidence "overwhelmingly established that [petitioners] wilfully and deliberately violated established law forbidding excessive mark-ups." *Id.* at 70a.

With respect to petitioner Brennan's personal responsibility for the fraudulent conduct, the district court found that petitioner was a " 'hands-on' manager who was intimately involved in the operations of First Jersey, including all significant decisions regarding the firm's underwriting, retail sales and trading activities." Pet. App. 78a; see also *ibid.* (finding that petitioner personally signed each of the underwriting agreements at issue in the case).[3] Because petitioner Brennan exercised such close control over the company's operations and personally participated in the operation of the fraudulent scheme, the district court found him liable as a primary violator of the antifraud provisions. *Id.* at 80a. The court also ruled that Brennan was jointly and severally liable as a "control person" of First Jersey, under Section 20(a) of the Exchange Act, 15 U.S.C. 78t(a). Pet. App. 80a-81a.[4] The court noted that petitioner "possessed con-

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[3] Petitioner Brennan never contended that the sales practices and price mark-ups were attributable to the unauthorized actions of other executives of First Jersey. Pet. App. 79a.

[4] Section 20(a) provides that any person who "controls any person liable under any provision of [the Exchange Act]" is "jointly and severally" liable to the same extent as the controlled entity, subject to a good-faith defense. 15 U.S.C. 78t(a).

trol over every aspect of First Jersey's operations" and that petitioner had "virtually conceded" his status as a control person at trial. *Id.* at 81a.

The district court enjoined petitioners from further violations of the antifraud provisions of the securities laws. Pet. App. 96a-98a. The court found it "highly likely that future violations might occur" (*id.* at 98a) because (i) petitioners' violations of the securities laws were "flagrant and deliberate," (ii) "[petitioner] Brennan is completely without remorse for the violations proven in this case," and (iii) even after their fraudulent scheme was uncovered, petitioners "continued to carry on business activities in the securities industry * * * offending various federal and state securities laws." *Id.* at 97a. In addition, the court ordered petitioners to disgorge $22 million in profits they obtained in the fraudulent scheme, along with prejudgment interest. *Id.* at 99a-102a.[5] The court held petitioners jointly and severally liable for the disgorgement, because they were each individually and primarily liable for the violations that occurred and because Section 20(a) imposes joint and several liability on Brennan as a control person of First Jersey. *Id.* at 101a. The court directed the Commission to "submit plans for disposition" of the disgorgement fund, and provided that those plans may include "a Court-approved plan of distribution." *Id.* at 225a.[6]

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[5] Although the district court found that petitioners enjoyed more than $27 million in wrongful profits, the disgorgement award was reduced to reflect the $5 million paid by petitioners to settle a class action. Pet. App. 13a.

[6] The district court also appointed a special agent to examine whether other violations occurred. Pet. App. 103a. The court of appeals reversed that aspect of the district court's

4. The court of appeals affirmed. Pet. App. 1a-47a. The court of appeals found no error in the district court's imposition of liability on petitioners for securities fraud violations. *Id.* at 21a-37a. With respect to the ordered disgorgement, the court of appeals held that the amount of disgorgement "is a reasonable approximation of First Jersey's unlawful profits from its fraudulent transactions and is not punitive in nature." *Id.* at 39a.

The court of appeals also rejected petitioner Brennan's claim that joint and several liability for the disgorgement was improperly imposed. The court noted that petitioner was both "primarily liable for the frauds at issue here, having been 'intimately involved' in their perpetration, and is also liable as a controlling person of First Jersey." Pet. App. 40a. In rejecting petitioner Brennan's contention that he should be required to disgorge only the exact amounts that he withdrew from the firm, the court of appeals stated that the contention "might be more persuasive if he had owned less than all of First Jersey's stock." *Ibid.* But since he was the firm's sole and complete owner, full liability for the disgorgement was appropriate: "[T]o the extent that the Firm's net worth was increased by its unlawful activities, so was Brennan's personal wealth." *Ibid.*

ARGUMENT

Petitioners do not challenge their legal responsibility for millions of dollars in securities fraud targeted at unsophisticated investors. Nor do they dispute the extensive factual findings chronicling their respon-

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order (*id.* at 44a-47a), and we have not sought review of that issue.

sibility for the fraud at issue and their perpetration of additional, unlawful financial schemes during the pendency of the present Commission proceeding. See Pet. App. 83a-93a (chronicling nearly twenty years of "regulatory agency brushes"). Petitioners seek this Court's review solely of the questions whether they may retain the profits of their wrongdoing and whether Brennan can escape Congress's imposition of joint and several liability. Because the court of appeals' decision is consistent with the decisions of this Court and other circuits and turns upon the unique factual circumstances surrounding petitioners' fraud, this Court's review is not warranted.

1. Petitioners contend (Pet. 7-21) that the court of appeals erred in concluding that federal courts may order disgorgement in Commission actions under Section 20(b) of the Securities Act, 15 U.S.C. 77t(b), and Section 21(d) of the Exchange Act, 15 U.S.C. 78u(d). That claim does not merit further review for three reasons.

a. First, as petitioners concede (Pet. 7), every court of appeals that has addressed the question has construed the relevant statutory provisions to authorize an order of disgorgement as ancillary to the authority to grant injunctive relief. See, *e.g.*, *SEC* v. *Bilzerian*, 29 F.3d 689, 696-697 (D.C. Cir. 1994); *SEC* v. *AMX, Int'l, Inc.*, 7 F.3d 71, 76 n.8 (5th Cir. 1993); *SEC* v. *Rind*, 991 F.2d 1486, 1490 (9th Cir.), cert. denied, 510 U.S. 963 (1993); *SEC* v. *Ridenour*, 913 F.2d 515, 517-518 (8th Cir. 1990); *SEC* v. *Blavin*, 760 F.2d 706, 712-713 (6th Cir. 1985); *SEC* v. *MacDonald*, 699 F.2d 47, 54 (1st Cir. 1983) (en banc); see also *Commodity Futures Trading Comm'n* v. *American Metals Exchange Corp.*, 991 F.2d 71, 76 n.9 (3d Cir. 1993) (acknowledging availability of disgorgement as

ancillary relief under securities laws).[7] Petitioner cites no court decision, nor are we aware of any, that has ruled otherwise.

b. Second, the court of appeals' ruling fully adheres to this Court's precedents. This Court has repeatedly held that, "[w]hen Congress entrusts to an equity court the enforcement of prohibitions contained in a regulatory enactment, it must be taken to have acted cognizant of the historic power of equity to provide complete relief," including the ordered return of ill-gotten gains. *Mitchell* v. *Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 291-292 (1960) (ancillary authority to order reimbursement when Congress authorizes the issuance of injunctions); see also *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 386-391 (1970); *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 398-399 (1946) (order for restitution of illegal rents inheres in statutory authority to grant injunctive relief); *Clark* v. *Smith*, 38 U.S. (13 Pet.) 195, 203 (1839); cf. *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282, 288 (1940) (construing jurisdictional provision of the Securities Act, 15 U.S.C. 77v).

Ordering disgorgement of the profits of wrongdoing falls within the historic scope of a court's injunctive authority. "Nothing is more clearly a part of the subject matter of a suit for an injunction than the recovery of that which has been illegally acquired and which has given rise to the necessity for

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[7] Although the Eleventh Circuit has not yet directly ruled on the question, it presumably would follow *SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978), in recognizing the availability of such relief. See *Bonner* v. *City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc) (adopting as binding precedent all decisions of the former Fifth Circuit issued before October 1, 1981).

injunctive relief." *Porter*, 328 U.S. at 399.[8] Indeed, courts have characterized disgorgement as "a continuing injunction in the public interest." *AMX, Int'l*, 7 F.3d at 76 n.8; see also *SEC* v. *Huffman*, 996 F.2d 800, 803 (5th Cir. 1993).

Petitioners' suggestion that this Court's precedents are "outmoded" (Pet. 18) provides no basis for review. Petitioners identify no Justice, let alone Court opinion, that has called for overruling the Court's century-old precedents regarding the scope of the federal courts' injunctive power. To the contrary, this Court has continued to apply *Porter* and its principles. See, *e.g.*, *California* v. *American Stores Co.*, 495 U.S. 271, 295 (1990) ("[W]hen Congress endows the federal courts with equitable jurisdiction, Congress acts aware of this longstanding tradition of flexibility."); *Amoco Production Co.* v. *Village of Gambell*, 480 U.S. 531, 542 (1987); *United States* v. *Rodgers*, 461 U.S. 677, 708 (1983); *Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313-318 (1982); *Califano* v. *Yamasaki*, 442 U.S. 682, 705 (1979); *Renegotiation Board* v. *Bannercraft Clothing Co.*, 415 U.S. 1, 19 (1974); *Mitchell*, 361 U.S. at 291-292.

Petitioners devote much energy to attacking the validity of *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) (see Pet. 18-20), which, in part, addressed the implication of statutory causes of action. Petitioners complain that, in finding an implied cause of action under

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[8] Petitioners attempt to distinguish *Porter* on the ground that the statute in that case empowered the court to enter an "injunction, *or other order*," while the statute in this case does not refer to "other order[s]." Pet. 11. This Court has already rejected that argument. See *Renegotiation Board* v. *Bannercraft Clothing Co.*, 415 U.S. 1, 19 (1974); *Mitchell*, 361 U.S. at 291.

the proxy provisions of the Exchange Act, *Borak* relied on "generalized statutory purpose rather than the actual language" (Pet. 18), and they assert that this aspect of *Borak* provides the sole foundation for the "mother circuit['s]" "seminal disgorgement case" (Pet. 7, 11), *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971), which the other circuits simply have "uncritically followed" (Pet. 8).

Petitioners' argument is mistaken and, indeed, "mirrors the very misunderstanding over the difference between a cause of action and the relief afforded under it" that this Court identified in *Franklin* v. *Gwinnett County Public Schools*, 503 U.S. 60, 69 (1992). *Borak*'s analysis of whether a cause of action existed is "analytically distinct" from the question presented here (and in the preceding disgorgement cases) of what relief is available for the Commission's established cause of action. *Davis* v. *Passman*, 442 U.S. 228, 239 (1979). It is thus not surprising that, despite petitioners' attempted linkage, *Texas Gulf Sulphur* never cited or relied upon *Borak*'s cause of action analysis. The court of appeals relied, instead, upon longstanding precedent from this Court, which petitioners do not challenge, regarding the scope of the federal courts' equitable powers. See *Texas Gulf Sulphur*, 446 F.2d at 1307 (citing *Mitchell*, *supra*; *Porter*, *supra*, and other cases); see also *SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978).[9]

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[9] In *Franklin*, 503 U.S. at 68, this Court relied on the portion of *Borak* that addresses the remedies available for a recognized cause of action. Thus, even had the court of appeals invoked *Borak*, this Court's decision in *Franklin* belies petitioners' argument that *Borak*'s analysis regarding the remedies courts may order is "outmoded."

Irrelevant for the same reason is petitioners' reliance on *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994); *Northwest Airlines, Inc.* v. *Transport Workers Union*, 451 U.S. 77 (1981); and *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11 (1979). See Pet. 13, 14 n.11, 19, 20. Each of those cases addressed the existence of a particular cause of action, not the remedies available for recognized causes of action. In short, petitioners seek review of a mode of statutory construction that simply is not implicated in this case.

c. Third, Congress has repeatedly affirmed its intention that disgorgement be available as a remedy under the securities laws. As an initial matter, Congress enacted Section 20(b) of the Securities Act, 15 U.S.C. 77t(b), and Section 21(d) of the Exchange Act, 15 U.S.C. 78u(d), against the backdrop of cases (discussed above) acknowledging the historic scope of the federal courts' power to issue injunctions and accompanying ancillary relief. See *American Stores*, 495 U.S. at 295; *Romero-Barcelo*, 456 U.S. at 313 ("These commonplace considerations applicable to cases in which injunctions are sought in the federal courts reflect a practice with a background of several hundred years of history, a practice of which Congress is assuredly aware.") (internal quotation marks and citation omitted); *Mitchell*, 361 U.S. at 291-292 ("When Congress entrusts to an equity court the enforcement of prohibitions contained in a regulatory enactment, it must be taken to have acted cognizant of the historic powers of equity to provide complete relief."); *Porter*, 328 U.S. at 398 ("[T]he comprehensiveness of this equitable jurisdiction is not to be

denied or limited in the absence of a clear and valid legislative command. * * * 'The great principles of equity, securing complete justice, should not be yielded to light inferences or doubtful construction.'") (quoting *Brown* v. *Swann*, 35 U.S. (10 Pet.) 497, 503 (1836)). When Congress employs terminology in a statute "in which [is] accumulated the legal tradition and meaning of centuries of practice, it presumably knows and adopts the cluster of ideas that were attached to each borrowed word." *Evans* v. *United States*, 504 U.S. 255, 259 (1992); see also *Field* v. *Mans*, 116 S. Ct. 437, 443 (1995).

Congress, moreover, has enacted four statutes strengthening the Commission's remedial powers since 1984. Insider Trading Sanctions Act of 1984 (ITSA), Pub. L. No. 98-376, 98 Stat 1264; Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA), Pub. L. No. 100-704, 102 Stat. 4677; Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act), Pub. L. No. 101-429, 104 Stat. 931; Private Securities Litigation Reform Act of 1995 (Litigation Reform Act), Pub. L. No. 104-67, 109 Stat. 737. Two of those statutes—ITSFEA and the Litigation Reform Act—contain provisions expressly recognizing that courts may order disgorgement in Commission actions brought under Section 21(d) of the Exchange Act.

ITSFEA added Section 20A(b)(2), 15 U.S.C. 78t-1(b)(2), to the Exchange Act. Subsection (b)(2) is entitled "Offsetting disgorgements against liability," and it provides that damages awarded in a private action to recover for insider trading

> shall be diminished by the amounts, if any, that [the violator] may be required to *disgorge, pursuant to a court order obtained at the instance of the Commission, in a proceeding brought under section 21(d) of* [*the Exchange Act*] relating to the same transaction or transactions.

Ibid. (emphasis added).

Similarly, Section 103(b)(2) of the Litigation Reform Act amended Section 21(d) of the Exchange Act to include a provision entitled "Prohibition of attorneys' fees paid from commission disgorgement funds." 15 U.S.C. 78u(d)(4) (Supp. I 1995). That provision states:

> Except as otherwise ordered by the court upon motion by the Commission, * * * funds *disgorged as the result of an action brought by the Commission in 'Federal court* * * * shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.

Ibid. (emphasis added).

Those provisions' express references to the existence of a disgorgement remedy in civil actions commenced by the Commission leave no doubt that Congress considers the injunctive authority granted in Sections 20(b) and 21(d) to include the historically acknowledged, ancillary power to order disgorgement. Congress's enactment of legislation premised on its understanding of an existing statute and affirmative ratification of the established construction is compelling evidence of the statute's proper meaning. See, *e.g.*, *Loving* v. *United States*, 116 S. Ct. 1737, 1749 (1996) (passage of a statute premised on a particular

construction of an existing statute "is entitled to great weight in statutory construction"); *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 846 (1986) (where Congress ratifies an administrative interpretation of a statute "with positive legislation, we cannot but deem the construction virtually conclusive") (internal quotation marks omitted); cf. *Musick, Peeler & Garrett* v. *Employers Insurance of Wausau*, 508 U.S. 286, 293 (1993). Petitioners' proposed construction of the Securities Act and the Exchange Act, by contrast, would render these express references to disgorgement superfluous and nonsensical. See *Field*, 116 S. Ct. at 442 n.7 (statute should be construed to avoid rendering other sections "nonsensical"); *Babbitt* v. *Sweet Home Chapter of Communities for a Great Oregon*, 115 S. Ct. 2407, 2413 (1995) (noting judicial "reluctance to treat statutory terms as surplusage").

In addition to these express statutory confirmations of the scope of courts' equitable power under Sections 20(b) and 21(d), the legislative histories of the ITSA, ITSFEA, and the Remedies Act demonstrate that Congress has legislated new remedies with the understanding that disgorgement was already available. ITSA's authorization of civil money penalties for insider trading violations built upon the preexistence of a disgorgement remedy:

> Perhaps the most widely-used remedy is the Commission's authority to bring actions in U.S. district courts to enjoin violations of the federal securities laws. * * * Once the equity jurisdiction of a court has been invoked on a showing of a securities violation, the court possesses the necessary power to fashion an appropriate remedy.

> Thus, the Commission may request that the court order certain equitable relief, *such as the disgorgement (giving up) of illegal profits.*

H.R. Rep. No. 355, 98th Cong., 1st Sess. 6-7 (1983) (emphasis added); see also *id.* at 7 ("The principal, and often effectively only, remedy available to the Commission against insider trading is an injunction against further violations of the securities laws and disgorgement of illicit profits."); *id.* at 8 ("The new penalty may be used in addition to existing remedies available to the Commission," such as "disgorgement of ill-gotten gains.").

The legislative history of ITSFEA again reveals Congress's recognition of the availability of disgorgement as a remedy and Congress's legislative reliance upon the existence of that relief for violations of the securities laws. See H.R. Rep. No. 910, 100th Cong., 2d Sess. 11 (1988) ("The creation of a new civil penalty [under ITSA] was intended to go beyond disgorgement of illegal profits to add the imposition of a significant fine as a needed deterrent," and ITSFEA builds upon that remedial foundation).

Finally, the Remedies Act authorizes "federal courts to order the payment of civil money penalties, in addition to disgorgement, for a broad range of violations of the federal securities laws." H.R. Rep. No. 616, 101st Cong., 2d Sess. 13 (1990). The section of the House Report entitled "Civil Money Penalties And Disgorgement" further noted:

> Currently, even a violator who is caught is required merely to give back his gains with interest, leaving him no worse off financially than if he had not violated the law. The Committee therefore concluded that authority to seek or impose sub-

> stantial money penalties, *in addition to disgorgement of profits*, is necessary for the deterrence of securities law violations that otherwise may provide great financial returns to the violator.

Id. at 17 (emphasis added).[10]

The Remedies Act also authorizes the Commission to order disgorgement in its administrative proceedings. See Exchange Act, § 21B(e), 15 U.S.C. 78u-2(e). The House Report's discussion of that new remedy observes that "[t]he Commission, of course, will continue to be able to seek disgorgement in its civil injunctive actions." H.R. Rep. No. 616, *supra*, at 35. Thus, petitioners' argument (Pet. 13-15) that the express authorization of disgorgement in administrative proceedings precludes a construction of Sections 20(b) and 21(d) that would allow such relief in civil actions gets congressional intent exactly backwards. The Remedies Act was designed to extend the Commission's well-established disgorgement authority in civil actions to the administrative arena.

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[10] See also H.R. Rep. No. 616, *supra*, at 22 ("[Court ordered civil money] penalties could be imposed in addition to orders of disgorgement directing a defendant to return the full amount of profits derived from a violation."); *id.* at 31 ("While Section 20 [of the Securities Act] currently does not refer to any form of civil relief other than an injunction, courts have recognized that, in Commission actions, they have the inherent power to order disgorgement, appointment of a receiver, or a prohibition against acting as a director or officer of reporting companies."); *ibid.* ("By specifying this particular type of ancillary relief, the section does not restrict the court's inherent equitable authority. These could include orders directing disgorgement of unlawful profits.").

In sum, petitioners err in contending (Pet. 10) that "[t]he precisely-calibrated remedial scheme that Congress put in place * * * does not provide for" disgorgement. Congress repeatedly has made clear that an important and well-established component of that "precisely-calibrated remedial scheme" is the power of the federal courts to require violators like petitioners to surrender their ill-gotten gains. Under these circumstances, it is petitioners' argument that threatens the proper boundaries between the legislative and judicial roles by inviting courts to ignore express congressional affirmation of and reliance on established judicial constructions of Acts of Congress and by lightly presuming a congressional intent to deny courts their inherent and long-recognized authority to order ancillary equitable relief.[11]

2. Petitioners also argue (Pet. 22-25) that, even if the remedy of disgorgement is available, the court of appeals erred in holding that Brennan is jointly and severally liable for the entire disgorgement amount. The court's ruling was correct and rested on the specific facts of this case, making further review unwarranted.

a. Section 20(a) of the Exchange Act, 15 U.S.C. 78t(a), expressly imposes joint and several liability on control persons, and petitioners do not question the court's finding that petitioner Brennan is liable as a

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[11] This Court has already rejected petitioners' additional contention (Pet. 19) that disgorgement is unavailable because the statutory injunctive remedy is forward-looking. See, *e.g.*, *Mills*, 396 U.S. at 386 (finding no merit to contention that equitable remedies under the Exchange Act are limited to prospective relief).

control person. Nor do petitioners contest that joint and several liability attaches in civil actions brought by the Commission. See Exchange Act, § 3(a)(9), 15 U.S.C. 78c(a)(9) (defining the term "person[s]," who can recover joint and several liability under Section 20(a), to include the Commission). Most of petitioners' objections about the supposed unfairness of imposing liability in this case thus simply reflect a disagreement with Congress's decision to impose joint and several liability on control persons. That, however, is an insufficient basis for this Court's review.

b. Petitioners assert (Pet. 23) that the court's imposition of liability on Brennan creates a circuit conflict by allowing disgorgement beyond the profits actually received. Petitioners are mistaken. No court has held that joint and several liability is inappropriate when a defendant has sole and complete operational and financial control over a company and has been found primarily and individually liable for each of the securities violations at issue. In fact, petitioners do not even identify a case that is factually analogous to the present case. There is thus no basis for believing that this case would have been resolved differently in any other circuit.

Petitioners' argument, moreover, is predicated upon an unduly restrictive view of the benefits Brennan received from the fraudulent venture. Although petitioners repeatedly assert (Pet. 3, 24, 25) that Brennan received less than $1 million from his illegal conduct, in fact, as they admit (Pet. 4), he received approximately $14 million in cash compensation from First Jersey during 1982-1985 alone. Pet. App. 130a. Brennan also received many millions more in cash

benefits from First Jersey.[12] Additionally, throughout the time of the fraudulent transactions (and beyond), Brennan's single-handed dominion over First Jersey allowed him to withdraw any amount of money from the firm at any time he desired. *Id.* at 40a.[13] The ready availability of this money meant that Brennan benefitted directly from any increase in the worth of the firm that arose from the wrongful conduct. *Ibid.* Further, the district court chronicled the extensive financial dealings (in the millions of dollars) that benefitted Brennan in the wake of defrauding First Jersey's investors (*id.* at 85a-93a), and concluded that "[n]one of this would in all probability have been achievable by him without the income produced by the illegal markups and what those sums enabled him and First Jersey to further obtain" (*id.* at 101a). Because the financial benefits Brennan received from the wrongdoing were so substantial and enduring, far exceeding what petitioners are willing to acknowledge, the court's order that Brennan be held liable for the entire disgorgement amount was appropriate. See *Blavin*, 760 F.2d at 713 ("Disgorgement orders are not limited to confiscation of trading profits," and may reach other financial benefits received by the wrongdoer.).

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[12] Petitioners ignore the $6.7 million that Brennan withdrew from the firm in 1986-1987 (which brought Brennan's total withdrawals for 1982-1987 to $20,700,694, see Pet. App. 130a); Brennan's receipt of $5 million for his "covenant not to compete" upon the sale of the bulk of First Jersey's retail offices in 1987 (Tr. 5616-5631 (Oct. 12, 1994)); and the millions of dollars that First Jersey paid out after 1987 to Brennan and for Brennan's benefit (Tr. 5431-5434 (Oct. 6, 1994)).

[13] In 1991, First Jersey spent $4.3 million to purchase securities for Brennan. Pet. App. 179a.

c. Petitioners are also incorrect in asserting (Pet. 25-27) that there is a circuit conflict concerning the right to a jury trial or the applicability of a statute of limitations in this case. As an initial matter, petitioners are in no position to raise a claim to a jury trial. The district court ruled that, assuming defendants were entitled to a jury, they had "waived their right" by failing to make a timely demand. C.A. App. 387-388 (noting that five years of pretrial preparation elapsed before petitioners requested a jury).

In any event, petitioners' arguments rest on the erroneous premise that the ordered disgorgement of unlawful profits is a penalty. While petitioners cite numerous cases supporting the unremarkable proposition that penalties are subject to the right to jury trial and applicable statutes of limitation, petitioners identify no case holding that the disgorgement of ill-gotten gains is a penalty, much less that it is a penalty to require one who orchestrated an unlawful scheme to disgorge fraudulently obtained funds over which he had complete control and which directly increased his net worth. See *United States* v. *Ursery*, 116 S. Ct. 2135, 2148-2149 (1996) (forfeiture of the proceeds of illegal activity serves the "nonpunitive goal of ensuring that persons do not profit from their illegal acts"); *SEC* v. *First City Financial Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989) (disgorgement is not penal as long as the amount is causally connected to the wrongdoing).

Petitioners also challenge (Pet. 25) the rate of prejudgment interest awarded. Petitioners' fraud essentially provided them with an unsecured, interest-free loan of the illegal profits they have been ordered to disgorge. The Internal Revenue Service underpayment interest rate, which the court applied, is a

reasonable approximation of the amount defendants would have had to pay for an unsecured loan of the amount obtained through fraud, because the underpayment rate conforms to the prevailing level of interest rates in the economy. See H.R. Rep. No. 426, 99th Cong., 1st Sess. 849 (1985); S. Rep. No. 313, 99th Cong., 2d Sess. 184 (1986).[14]

To be sure, the amount required to be disgorged in this case is large, but the fraud was immense and long lasting, and the unlawful profits large. Far from

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[14] Petitioners are incorrect in asserting that the Commission has acknowledged that "any funds obtained through disgorgement will be paid to the U.S. Treasury and *not* to the victims of the alleged fraud" (Pet. 5, 17). Petitioners' transcript citations do not support their assertion. The Commission's well-established position is that the primary purpose of disgorgement is to deter violations by depriving wrongdoers of their ill-gotten gains, not to compensate victims. See also *Ursery*, 116 S. Ct. at 2148-2149; *Randall* v. *Loftsgaarden*, 478 U.S. 647, 663 (1986) ("[I]t is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them."); *Jackson* v. *Smith*, 254 U.S. 586, 588-589 (1921) (imposing joint and several liability on a receiver and his associates to account for all profits made by them through self-dealing in assets of a trust estate, even though "the estate may not have been injured" by their misconduct). Once the money is recovered, however, the Commission generally seeks to restore those funds to the victims through a court-approved distribution plan if they received less than full recovery in any private litigation brought on their behalf. Alternatively, the funds are sometimes paid into the Treasury. See generally *SEC* v. *Wang*, 944 F.2d 80, 81-82 (2d Cir. 1991); Paul Gonson & Randall Quinn, *The Disgorgement Dilemma: Who Gets the Money Recovered by the SEC in Insider Trading Cases?*, 35 Fed. B. News & J. 192 (1988). In any event, petitioners' complaint is premature because the district court has not yet approved any plan for distribution of the disgorged funds in this case.

being a ground for extending Brennan special consideration, the enormity of Brennan's wrongdoing and of the financial benefits he reaped from the scheme fully justifies the remedial decree entered.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 96-1862

In the Supreme Court of the United States

OCTOBER TERM, 1997

FIRST JERSEY SECURITIES, INC. AND ROBERT E. BRENNAN, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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THE QUESTIONS PRESENTED HAVE EXCEPTIONAL IMPORTANCE TO THE ADMINISTRATION OF THE FEDERAL SECURITIES LAWS

The Commission's brief in opposition is more notable for what it fails to dispute than what it affirmatively argues. The SEC does not deny that the only provisions of the securities laws *which authorize government relief in court* are confined explicitly to forward-looking injunctive relief, and do not authorize disgorgement. Nor does the SEC deny that the securities laws are replete with other provisions stating in the most precise terms what remedies Congress intended to authorize to achieve "deterrence." The SEC unaccountably mischaracterizes this case as having "unique factual circumstances." Br. 8. Yet, it does not question our demonstration that the disgorgement remedy is the most commonplace remedy in the agency's arsenal today, and has yielded billion-dollar annual recoveries. Nor does it deny that the threat of potentially ruinous disgorgement orders — bounded only by the trial court's unfettered "discretion" — is sufficient to coerce brokers, securities professionals, and corporate issuers to enter into virtually any settlement the agency demands.

As stated by a former General Counsel of the Commission, the "ancillary relief" theory advanced in this case means, as a practical matter, that "the range of remedies available is seemingly unlimited."[1/] SEC Chairman Richard Breeden has declared that these implied powers should be used aggressively by the Commission's enforcement lawyers to ensure that securities defendants are left "naked, homeless, and without wheels."[2/] True to the Chairman's word, the petitioners in this case have been forced into bankruptcy by the disgorgement remedy, which requires petitioner Brennan to give up gains ("illicit" or not) which he never received,

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[1/] Steinberg & Ferrara, Securities Practice § 5:09 at 24-25 (1992).

[2/] Quoted in Eisenberg, *Enforcement Issues and Litigation*, 21 Sec. Reg. L. J. 421 (1993).

pursuant to statutes which do not authorize such a radical judicial sanction.

As discussed in greater detail below, the Commission's defense of disgorgement rests on a patent misreading of this Court's precedents in cases like *Porter* and *DeMario*. Those decisions repeatedly state that judicially-implied remedies may not be engrafted on top of enforcement provisions that are expressly set forth in comprehensive enactments such as the federal securities laws. As this Court has stressed in its recent relevant decisions: "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Transamerica,* 444 U.S. at 19.

In an effort to bypass these precedents of this Court, the Commission falls back on the familiar refrain that Congress has "ratified" the SEC's interpretation through subsequent legislative history and later statutory enactments. In so arguing, however, the SEC does not even mention this Court's directly relevant decisions, including *SEC* v. *Sloan*, which rejected identical ratification arguments (436 U.S. at 119-122), and which made clear that when the Commission demands "awesome power with a potentially devastating impact" (*id.* at 112) that is "extremely far reaching" (*id.* at 121), a "clear mandate from Congress" is "necessary to confer this power" (*id.* at 112, 122). The subsequent statutory enactments cited by the SEC (Br. 13-17) address collateral issues unrelated to those presented here, and do not, by any stretch of the imagination, constitute a "clear mandate from Congress" authorizing such potentially devastating disgorgement orders.

Given the lack of statutory support for this $75 million sanction and the undisputed fact that petitioners have long ago settled or adjudicated *all* customer claims (Pet. App. 230a-245a), the Commission accomplishes nothing by rhetorically denouncing the "enormity of Brennan's wrongdoing." Br. 23. In condemning the amount of the "markups" charged by First Jersey, the courts below were required to make new law on a

retroactive basis and to resolve against petitioners a host of highly subjective issues, as shown by the opinions below. See Pet. App. 27a-32a, 70a-78a (the markup issue is "determined differently depending upon a number of factors," all highly fact-specific in nature). Petitioners offered detailed evidence at trial, including the testimony of the SEC's former chief economist, showing that the markups were justified under past industry and regulatory practice. Nevertheless, in a radical departure from its own precedents, the Commission attacked petitioners' markups by comparison to retail prices, ignoring wholesale prices previously relied upon; compared the prices of securities that were liquid and illiquid as if they were fungible products; and applied a newly-minted "unit cost" allocation formula which the district court acknowledged "has not received prior judicial imprimatur." *Id.* at 78a n. 23.

These are the very circumstances which have caused this Court to insist on a restrained interpretation of the agency's enforcement powers. *Dirks*, 463 U.S. at 664 n. 24 ("Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain"); Karmel, *Regulation by Prosecution*, 201 ("The potential for abuse is great when a government prosecutor is not held to the limitations and standards of a specified statutory remedy").[3/]

As in the many past cases cited in our petition where this Court rejected erroneous legal interpretations proffered by the SEC (Pet. 8), a grant of certiorari is urgently called for to bring the Commission's enforcement powers into harmony with the plain language of the securities laws and to reconcile prior lower court rulings with this Court's precedents. The

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[3/] See Cox, Hillman & Langevoort, *Securities Regulation*, 26 (1991) ("the Commission jealously seems to preserve the largest degree of discretion to sanction conduct that it determines, after the fact, to have been improper"); Winter, *Raising the Cost of Capital in America*, 42 Duke L. J. 945, 963-964 (1993) (the present "relentless drive" to "increase the discretionary power" of prosecutors and regulators of capital markets "moves in entirely the wrong direction").

extraordinary practical importance of this case to all market participants cannot seriously be disputed. Nor can the Commission seriously contest the need for establishing standards for the exercise of discretion which, in this case, has forced petitioner Brennan to disgorge "ill gotten gains" he never received, to surrender entirely lawful proceeds, and to pay more than $50,000,000 in interest on these phantom profits.

THE DISGORGEMENT ORDER CONFLICTS WITH THIS COURT'S PRECEDENTS

1. We admire the Commission's courage, if not its prudence, in arguing (Br. 12) that this Court's decisions in *Redington*, *Central Bank*, and *Transamerica* are simply "irrelevant" here. Unlike the cases which the Commission cites (Br. 9-10), these cases are squarely applicable because they interpret the provisions of the federal securities laws and arise in the modern era of statutory interpretation. Here, as in *Redington*, *Central Bank*, and *Transamerica*, the "existence" of a disgorgement remedy (Br. 12) could only have been divined by judicial implication. But these cases make clear that it is not the role of the judiciary "to fill any *hiatus* Congress has left in this area." *Redington*, 442 U.S. at 579. It is an "elemental canon of statutory construction" that a "particular remedy" fashioned by Congress "includes the negative of any other mode." *Transamerica*, 444 U.S. at 19-20.

It is equally fruitless for the Commission to invoke the "historic scope of a court's injunctive authority" (Br. 9, 12). By combining the unauthorized remedy of disgorgement with "joint and several" or "control person" liability — thereby forcing petitioner Brennan to disgorge "ill gotten profits" he never received for the benefit of persons who were owed no debt — the Commission has obtained a remedy without historical pedigree. In contrast to the simple reimbursement ordered in *Porter* and *DeMario*, the Commission's punitive remedy here is unprecedented and contrary to this Court's decisions declaring that Congress intended the injunctive provisions of the securities laws to be applied with "mercy

and practicality," "not to punish." *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 60-65 (1975); *Aaron* v. *SEC*, 446 U.S. at 701, 703 (equity balances "the public interest and private needs"; even a prospective injunction, without disgorgement, "is a drastic remedy, not a mild prophylactic").

Beyond this, the cases cited by the SEC (Br. 9-10) only serve to confirm that the disgorgement order here is in conflict with this Court's precedents. Like *Porter* and *DeMario* (see Pet. 21-22 n. 18), they repeatedly reaffirm that "[s]tatutory rights and obligations are established by Congress, and it is entirely appropriate for Congress, in creating these rights and obligations, to determine in addition who may enforce them and in what manner." *Davis*, 442 U.S. at 241. Thus, courts are permitted to imply remedies only "when Congress has given no indication of its purpose with respect to remedies," not where, as here, it has "expressly enumerated the remedies available." *Franklin*, 503 U.S. at 68-69 & n. 6.

Stated otherwise, "where a statute creates a right and provides a special remedy, that remedy is exclusive"; courts must defer to Congress when it has "selected the precise machinery and fashioned the tool which it deemed suited to that end." *Bannercraft Clothing*, 415 U.S. at 18. And while judicial implication of a remedy may be proper where Congress intended to afford a particular remedy without providing "clear indications" of the details of the available relief (*Musick, Peeler*, 508 U.S. at 293), such law-making is completely beyond the judicial function where, as here, Congress has already "meticulously detailed the remedies available" (*Mills*, 396 U.S. at 391). The disgorgement order sustained by the Second Circuit clashes fatally with these basic principles because Sections 20(b) and 21(d) of the 1933 and 1934 Acts expressly provide for the exclusive remedy of injunctive relief.[4/]

[4/] The SEC nowhere comes to grips with the plain language of Sections 20(b) and 21(d). Unlike the Emergency Price Control Act considered in *Porter*, 328 U.S. at 399, which authorized an injunction "or other

(continued...)

2. Relying once again on decisions of this Court addressing unrelated statutes (Br. 12, 14-15), the Commission claims that subsequent statutory enactments (relating to other subjects) and subsequent legislative history serve to ratify its expansive interpretation of Sections 20(b) and 21(d) of the 1933 and 1934 Acts. The agency makes this argument without disclosing that this Court has rejected such contentions in virtually every case in which the SEC has made them. Most recently, this Court held in *Central Bank*, 511 U.S. at 185-188, 192, that even where Congress "has amended the securities laws" with full knowledge of an SEC interpretation approved "[i]n *hundreds* of judicial and administrative proceedings in every Circuit in the federal system," "it does not follow that Congress' failure to overturn a statutory precedent is reason for this Court to adhere to it," since it is "impossible to assert with any degree of assurance" that there is "affirmative congressional approval" of the agency's view.

Before *Central Bank*, in a long line of decisions this Court repeatedly rejected SEC ratification arguments based on subsequent statutory amendments and legislative history. See *Sloan*, 436 U.S. at 112, 119-123 (even where Congress reenacts the securities laws with full knowledge of the SEC's interpretation, this does not constitute "approval" of "awesome" or "sweeping" remedies, which require "clear" and "unmistakable" authorization); *Aaron*, 446 U.S. at 694 n. 11 (securities law amendment, made with full knowledge of the SEC's views, "falls far short of providing a basis to support a construction" of the laws at odds with their "plain meaning"); *Transamerica*, 444 U.S. at 23 n. 13 ("subsequent legislation can disclose little or nothing of the intent of

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[4/](...continued)
order," Sections 20(b) and 21(d) authorize only a forward-looking "injunction or restraining order" to halt specific "acts or practices" that violate these statutes. It is hard to envision language less suggestive of the open-ended disgorgement remedy demanded by the SEC. Other provisions of these laws deal precisely (and subject to safeguards) with investor compensation and imposition of fines and penalties. Pet. 14-15.

Congress in enacting earlier laws"); *Dunn*, 117 S. Ct. at 920 (a subsequent amendment, made with knowledge of the agency interpretation, "sheds no light on the intent of the authors" of the original law); *Redington*, 442 U.S. 575 n. 16 (subsequent enactments lack "relevance," since it is "our task * * * to discern the intent of Congress when it enacted § 17(a) in 1934").

These principles apply with special force here. First, the statutory provisions relied on by the SEC do not come close to "approving" or "ratifying" a disgorgement remedy in SEC injunctive actions. The 1988 Insider Trading Enforcement Act, 15 U.S.C. 78t-l(b)(2), provides simply that private damage recoveries must be "diminished" by amounts, "if any," obtained in a disgorgement proceeding. The 1995 Litigation Reform Act, 15 U.S.C. 78u(d)(4) (Supp. I 1996), merely recites that any disgorged funds "shall not be distributed as payment for attorneys' fees." As shown by their plain language, these laws address special abuses — double recoveries by plaintiffs and overreaching by lawyers seeking fees — without declaring that disgorgement (especially disgorgement without limitations or safeguards) is authorized in federal court proceedings. They plainly do not provide the kind of "clear mandate" which this Court required in *Sloan* to authorize such "awesome power with a potentially devastating impact."

Beyond this, this Court already has held that the Insider Trading Enforcement Act, "which became law more than 50 years after the original securities statutes, focuses upon a specific problem" and there is "no indication that the drafters * * * sought to extend that enhanced protection to other provisions of the 1934 Act." *Lampf*, 501 U.S. at 361. The statutory language "makes clear that the 100th Congress sought to alter the remedies available in insider trading cases, and *only* in insider trading cases." *Id.* at 362. Thus, as to both the 1988 and 1995 enactments, "the legislative consideration of those statutes was addressed principally to

matters other than that at issue here" and "falls far short" of legislative authorization of disgorgement in injunction cases. *Aaron*, 446 U.S. at 694 n. 11.

Finally, this Court repeatedly has held that even if the Congressional understanding of a statute's meaning is expressly stated in subsequent amendments, that opinion of the later Congress "does not command our obedience" and "does not control the issue," even though it conveys a "sense of what Congress * * * understood." *Mackey* v. *Lanier Collection Agency*, 486 U.S. 825, 839-840 & n. 15 (1988); accord, *R. J. Reynolds Co.* v. *Durham County*, 479 U.S. 130, 151-152 n.22 (1986) (subsequent enactments with a "narrow focus," which imply a particular interpretation of prior law, are "not persuasive as to Congressional purpose"). Those principles are dispositive here.

This is not a case like *Loving*, 116 S. Ct. at 1749-1750, where a group of laws, considered "together," "give clear authority" to the agency. Accord, *Schor*, 478 U.S. at 845-846 ("Congress explicitly affirmed the CFTC's authority"). To the contrary, the plain language of Sections 20(b) and 21(d) authorizes prospective injunctive relief, and nothing else. If Congress meant to expand these injunctive powers to include a highly draconian form of disgorgement — and to reject established equitable principles announced in cases like *Rondeau* — it knew how to do so and had every opportunity to do so over a period of many years. Courts should not distort the legislative compromise, or bypass the requirements of bicameralism and presentment, by "filling in" this highly controversial "hiatus," which Congress has never seen fit to do.[3/]

[3/] The above-cited authorities also make clear that the Commission's reliance on subsequent legislative history is completely misguided. As stated in *Central Bank*, 511 U.S. at 185, the interpretation "given by one Congress (or a committee or Member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute."

THE DISGORGEMENT ORDER CLASHES WITH SETTLED LAW IN OTHER CIRCUITS

The completely standardless award of disgorgement in this case conflicts sharply with the law in other Circuits. The Commission does not dispute that petitioners paid over $12 million in settlement and obtained releases from all of their customers, thereby resolving all customer claims, including any investor rights under "the disgorgement claims" now pressed by the SEC. Pet. App. 240a. The Commission also does not dispute that the amount of money received by petitioner Brennan from the challenged securities transactions was only $906,672. *Id.* at 228a. Yet incredibly it asserts (Br. 19) that there is "no basis for believing that this case would have been resolved differently in any other circuit."

The cases cited in our petition (at 23) make clear that several other Circuits would forbid any disgorgement order — such as the $75 million order here — that exceeds the amount actually earned by the defendant through alleged illegal acts. See also *Hateley* v. *SEC*, 8 F.3d 653, 655-656 (9th Cir. 1993) (a defendant found jointly and severally liable could not be charged for profits received by a co-defendant; "it was error to base disgorgement upon the total amount of commissions that were generated * * * instead of upon the amount of commissions that Cambridge actually retained"); *Nelson* v. *Serwold*, 687 F.2d 278, 281 (9th Cir. 1982) (defendant "should not be made to disgorge the profit from the sale of the stock owned by other members of the control group because [he] did not benefit from that profit"); *SEC* v. *MacDonald*, 699 F.2d 47, 54-55 (lst Cir. 1983) (en banc) (disgorgement extends only to profits from "wrongdoing," not other sources; "[a]ny further sum would constitute a penalty assessment").

The SEC nonetheless argues (Br. 19-20) that even though "Brennan received less than $1 million from his illegal conduct," he actually owes $75 million because he obtained unrelated "compensation" from First Jersey, had other money "available," and "benefitted" generally from the operations of the brokerage firm. None of this has the slightest relevance. As the SEC's authorities repeatedly state, disgorgement

reaches only "ill-gotten gains" (*SEC* v. *First City Financial*, 890 F.2d 1215, 1231(D.C. Cir. 1989)), not money that might have been (but was not) received, and not money gotten years later from unrelated business operations and transactions that never were proven to be unlawful. The SEC "must distinguish between legally and illegally obtained profits." *Ibid.*

The Commission's refusal to draw that basic distinction confirms the radical nature of its disgorgement theory and the need for this Court's review. If the SEC's approach were valid, *any* profit earned from a securities law violation would be sufficient to taint the future operations and earnings of a brokerage firm or other securities defendant — resulting in personal liability for disgorgement "in an indeterminate amount" and for "an indeterminate time." *Hochfelder*, 425 U.S. at 215 n. 33.

Whether traditional legal limitations apply to SEC disgorgement orders, as opposed to open-ended concepts of discretion, is a question that vitally affects a large number of litigated and settled cases every year, and which will continue to cause uncertainty in the lower federal courts until reviewed by this Court. This Court should grant certiorari to resolve the conflict among the Circuits, and to make clear that the Commission may not obtain billion-dollar annual recoveries in federal court in the absence of statutory authorization and on grounds that are purely subjective, standardless, and unreviewable.[9]

Respectfully submitted.

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[9] See *Central Bank*, 511 U.S. at 188-189 (criticizing "decisions made on an ad hoc basis, offering little predictive value," which cause businesses "to abandon substantial defenses" to "avoid the expense and risk of going to trial"); Dent, *Ancillary Relief*, 67 Minn. L.Rev. at 925 ("Effective appellate review is especially problematic in ancillary relief cases. * * * [T]he Supreme Court can review such cases only rarely. *To exercise any control at all, it must limit district court discretion*") (emphasis supplied).

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